Willem F Duisenberg: The path towards a single currency

Reply by Dr Willem F Duisenberg, President of the European Central Bank, on the occasion of receiving the Grand Cross 1st class of the Order of Merit of the Federal Republic of Germany, Frankfurt am Main, 24 July 2002

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First, I should like to sincerely thank the President of the Federal Republic of Germany, represented here today by the Finance Minister, Mr. Eichel, for awarding me the Grand Cross 1st class of the Order of Merit of the Federal Republic of Germany. I feel deeply honoured. I would also like to thank the Finance Minister for his kind words. And I am grateful to all of you here for sharing this special moment with me.

To be mentioned in the same distinguished company as Karl Otto Pöhl, Helmut Schlesinger and Hans Tietmeyer is a great honour for a former President of the Dutch central bank. In the early 1970s, *De Nederlandsche Bank* and, in particular, my predecessor there, Jelle Zijlstra, realised that the Netherlands, as a relatively small and open economy, had no other option than to orient its monetary policy towards its main trading partner and neighbour, Germany. Moreover, by doing so, we thought we could 'import' the credibility of German monetary policy and transfer the internal stability of the Deutsche Mark to the Dutch guilder. This policy was contentious and *De Nederlandsche Bank* rather cautiously adopted an exchange rate target policy. Indeed, in my early years as President of the Dutch central bank, I was confronted - in 1983 - with the decision of the Dutch government not to revalue the Dutch guilder in the European Exchange Rate Mechanism to the same extent as the German currency; a decision taken against the explicit advice of the Dutch central bank. This decision resulted in a divergence between Dutch and German interest rates, which, unfortunately, came to haunt the Netherlands for almost eight years. The most important lesson of this event - for me and also for the government - was that to gain credibility in financial markets was very difficult, but to lose credibility was very easy.

After 1983, the exchange rate of the guilder was more or less pegged to the exchange rate of the Deutsche Mark. And as was expected in the 1970s, price developments in the Netherlands very much mirrored those in Germany. The success of Dutch monetary policy became very obvious during the upheaval in the European Monetary System in July 1993, when it was decided to widen the fluctuation bands of the Exchange Rate Mechanism. Only the tight link between the Dutch guilder and the Deutsche Mark, sealed with an exchange of letters between the *Deutsche Bundesbank* and *De Nederlandsche Bank*, survived this storm. Apparently, the credibility of Dutch monetary policy was restored again.

In parallel to these developments, a vision even more daring than the close link between the Dutch and German currencies was gaining the attention and support of European leaders: the introduction of a single currency in Europe. One of its fathers, the former Prime Minister of Luxembourg Pierre Werner, only very recently passed away. It is unfortunate that his proposal to achieve monetary union by the end of the 1970s did not succeed, and I take this opportunity to pay him the tribute he deserves. But this failure probably did not harm Europe, because at the time the single market was far from completion. Indeed, the political aspirations behind a single currency in Europe were running too far ahead of the economic realities. By contrast, failing to introduce a single currency following the Maastricht Treaty would have been considerably more damaging.

The path towards a single currency was a tortuous one. The whole plan, laid down in the Werner Report, was put aside amid the global currency turmoil in the early 1970s and the subsequent economic recession. But the vision of establishing a single currency in Europe gained new momentum after the ratification of the Single European Act in 1987, which laid the foundations for the European Single Market. The idea, rightly so in my view, was that it would not be possible to reap all the benefits from an internal market if it were still subject to exchange rate fluctuations. Moreover, the free movement of capital, fixed exchange rates and sovereign national monetary policies were generally regarded as mutually incompatible. (A view first expressed by my colleague on the Executive Board of the ECB, Tommaso Padoa-Schioppa). The initiatives taken at that time, however, would not have been possible without the political will and courage to create a single currency in Europe. Indeed, this process, which eventually led to the introduction of the euro banknotes and coins on 1 January of this year, required considerable resolve on the part of the German government.

In the run-up to the introduction of the euro, Germany proved to be a staunch supporter of a single currency enshrined in a stability-oriented culture. The internal value of the single currency would have to be at least as stable as that of the Deutsche Mark. If there were any country in Europe that had full understanding of Germany's concerns at that time, it was perhaps my own country, and not only because the Netherlands had benefited enormously from the stability-oriented monetary policy of the *Deutsche Bundesbank*. The Netherlands had also learnt the merits of having a stable currency and low inflation. Hence, in the process leading to monetary union in Europe, Germany was strongly supported by the Dutch government and, in particular, by the Dutch central bank. Indeed, I would say that the Netherlands has frequently been an even more ardent defender of the currency stability faith than Germany. As a small country, and one known for its directness and candour, the Netherlands could often adopt positions and policies that Germany, as a big player in Europe, could not, or only in a nuanced way.

In this context, I should like to thank the German government for the trust it has placed in me as the "guardian" of the new currency, to the extent that any one person can perform that task. I also wish to pay tribute to the German government for having the courage to "sacrifice" the Deutsche Mark, a symbol of German identity, and to give its support to the euro, an unknown quantity at that time, in the interests of peace and prosperity in Europe. I am of course also very grateful for the kind words expressed by Mr. Eichel as regards my role in the euro cash changeover. However, it should not be forgotten that the success of the euro so far - in particular the success of the cash changeover - should, at least in my view, be attributed first and foremost to the people of Europe. Without their support, the undertaking would have failed. And without their support for a stability-oriented monetary policy, it would not have been and will not be possible to safeguard the value of the currency.

In your speech, Mr Eichel, you echoed the words in the citation for the Order of Merit, namely that the European Central Bank has done well in ensuring price stability in the early years of monetary union, reflected in an annual average inflation rate of 2% over this period. Economic actors share the German government's view in this respect, as is evidenced by various indicators of inflationary expectations. However, there is no reason to be complacent. In 2000 inflation in the euro area was 2.3%; in 2001 it was 2.5%. For this year, we expect the average inflation rate to be just above 2%. The ECB should and will remain vigilant in order to maintain its credibility and to retain the support of the citizens of Europe. I have already alluded to my own experience in this respect as President of the Dutch central bank: credibility is much easier to lose than to gain.

In this context, I should like to emphasise that the ECB alone cannot ensure a stable macroeconomic environment, or only at rather high cost. The success of a stability-oriented monetary policy also depends on wage moderation, which is the responsibility of social partners, and a sound fiscal policy, which is the mandate entrusted to European governments, as laid down in the Stability and Growth Pact. I am pleased to hear today, Mr. Eichel, that the German government continues to commit itself to achieving the objectives of the Pact. In your speech, you praise my achievements as Minister of Finance of the Netherlands. I must admit that the policy which I pursued in the early 1970s, which entailed an increase in the tax and social security burden of no more than 1 percentage point of the national income per year and which should be seen against the macroeconomic background of the early 1970s, would definitely not be in line with current thinking about fiscal policy.

It is not surprising that the stability-oriented culture and the framework which should ensure macro-economic stability is being tested, in particular at the current stage of the business cycle. However, I believe that the macroeconomic policy framework, in particular the Stability and Growth Pact, provides enough flexibility for fiscal policy-makers, contrary to what some critics argue, as long as governments adhere to the rules of the Pact. This is also clearly shown by the fiscal policy of some Member States. Moreover, I think that it would be a big mistake, and detrimental to the stability-oriented culture, to change the macroeconomic policy framework laid down in the Maastricht Treaty, be it fiscal or monetary policy.

Distinguished guests, ladies and gentlemen, dear Mr. Eichel, the recognition I have received today is greatly appreciated. Although the ECB is an independent institution, as are its decision-makers, the government of the largest country of the European Union evidently believes that I have done my job as I am supposed to do. This expression of confidence makes the responsibility I am bearing as President of the ECB indeed feel somewhat lighter.

Again, I thank you very much for this decoration.