Willem F Duisenberg: Perspectives on EU enlargement

Speech by Dr Willem F Duisenberg, President of the European Central Bank, on the occasion of receiving an honorary doctorate from IMADEC University, Vienna, 14 October 2002.

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Dear Klaus,

Ladies and gentlemen,

It is a great privilege for me to be awarded an honorary doctorate today by such a distinguished institution, IMADEC University, in Austria. It is also a great pleasure to hear the kind words of my colleague and friend, Governor Klaus Liebscher.

When listening to Klaus Liebscher, who has indeed studied my *curriculum vitae* in great depth, Shakespeare's words came to my mind and I thought for a moment he had come to bury me, although he has actually come to praise me. I am afraid that this is the fate of anybody whose retirement comes within sight. Nothing but good should be said of the dead, they say. Considering that I am still alive, it is even more gratifying to hear nothing but good things about myself; perhaps with the exception of my addiction to tobacco - an addiction that Klaus and I happen to share.

There is one thing I should like to emphasise in the laudation. As Klaus Liebscher has just said, my career has benefited from a "*Summe von Zufälligkeiten*" that I have been lucky enough to encounter throughout my professional life. Hard work, clear objectives and a predilection for one's profession are necessary but not always sufficient conditions for success; being in the right place at the right time is likely to provide momentous opportunities that may contribute to making anyone's career more challenging.

However, in my reply to Klaus Liebscher's laudation, I should like to leave the past at rest and focus on the future, just as Klaus has done in the second part of his speech. I should particularly like to make a link between Klaus's comments about the importance of stability-oriented macroeconomic policies - to which I fully subscribe - and one of the key challenges the European Union is facing, enlargement, most likely involving ten new member countries. The enlargement of the European Union is a subject that has received much interest in this country in particular, given its proximity to central and eastern Europe. Indeed, the accession of ten new countries will now place Austria in the geographical heart of the European Union, although Austria has already been at the heart of the European integration process as such since its own accession to the European Union in 1995.

In my speech today, I should like to address the importance of stability-oriented and sound macroeconomic policies for the accession countries, particularly now in the run-up to full EU membership. Let me briefly elaborate on three aspects which lie at the core of stability-oriented policies in the accession countries: first, the need to enhance central bank independence; second, the importance of fiscal discipline; and, third, the implementation of further structural reforms.

As regards the first point, most accession countries have modified - or are in the process of modifying - their respective EMU-related legislation to ensure compliance with the requirements of the Treaty. However, central bank independence in accession countries should not be seen only as a legal requirement under the *acquis communautaire* but also as an important impetus to and precondition for policies geared towards monetary stability and nominal convergence with the EU. Indeed, if the drafters of the Treaty placed a strong emphasis on central bank independence, it is because of the conviction that the achievement of price stability is best served by an independent institution with a well-defined mandate. In line with this approach, the forerunner of the European Central Bank (ECB), the European Monetary Institute (EMI), established a list of parameters of central bank independence, which form the basis for assessing accession country compliance with this requirement by the ECB when evaluating the new Member States' convergence processes.

The process of enhancing central bank independence has not been smooth in all accession countries but, overall, it is now well advanced and its benefits are already apparent. Indeed, most accession countries have made significant progress in terms of disinflation. In 2001, average inflation rates in the region as a whole fell to single figure levels for the first time since the fall of the iron curtain and, thereafter, they have continued to decline. In this context, let me highlight that, bearing in mind the potential inflationary pressures that might arise from completing structural reforms, the conduct of a monetary policy in the accession countries aiming at price stability should be seen as a medium-term objective, rather than as a short-term target.

However, the sound management of macroeconomic policies cannot rely on monetary policy alone. In particular, stability-oriented policies in accession countries need to be supported by sound fiscal policies.

Prudent fiscal policy management has been key to making sustainable progress in terms of macroeconomic stabilisation in the accession countries. At the beginning of the transition to a market economy, poor tax collection and governments' limited access to financial markets led to substantial monetisation of public deficits. However, from the mid-1990s onwards, fiscal policy has focused on macroeconomic stability. Therefore, a key lesson from the accession countries' experience is that responsible fiscal policy has been a crucial element in achieving and maintaining macroeconomic stability. Looking ahead, the best contribution that fiscal policies can make to sustainable non-inflationary growth is by pressing ahead with fiscal consolidation, as is necessary to ensure the flexibility needed to deal with potential domestic and/or external economic shocks in the medium term.

Regrettably, fiscal developments have worsened recently in a few accession countries, reflecting ongoing restructuring programmes and higher expenditures related to the adoption of EU standards, but also the lack of a realistic medium-term fiscal strategy. In addition, structural deficits have become rather large and public debt ratios have started to increase, limiting the room for manoeuvre of automatic stabilisers. Overall, the need for further fiscal consolidation seems overwhelming, as fiscal slippages could put under pressure and even endanger the macroeconomic stabilisation achieved thus far.

Finally, let me turn briefly to the third component of, or perhaps better complement to, stability-oriented policies in accession countries that I will be addressing today: the implementation of further structural reforms.

Stability-oriented policies can best be supported by structural reforms, as they enhance the flexibility of the economy to adjust to necessary changes and cope with potential shocks. Moreover, structural reforms are also key determinants of the medium-term growth potential. In the case of the accession countries, structural reforms are even more important because they are necessary to complete the full adjustment of the accession countries' economies toward well-functioning market economies, including the setting-up of appropriate institutions and the adoption of international best practices in a number of areas. Completing this agenda is a challenge for the accession countries, particularly because of the sheer magnitude of pending reforms. Moreover, structural changes may complicate the conduct of monetary policy, as structural reforms may cause structural breaks that complicate the pursuit of credible disinflationary policies. Also, the calendar for further price liberalisation, which has an impact on inflationary developments, is often set by each government and is thus difficult for a central bank to predict.

From an ECB perspective, financial sector reform is also of the utmost importance. The reasons for this are mainly twofold. First, sound financial sectors are key to delivering "*stable money*". Weak financial systems tend to blur the monetary transmission mechanism and the capacity of monetary policy to influence inflation and growth outcomes, putting the maintenance of price stability and the credibility of the central bank at risk. Second, financial sector reform is needed because it ensures that structural reforms, particularly in the goods and labour markets, become fully effective. Indeed, despite recent structural reforms and positive growth, the catching-up of per capita income with the euro area has remained limited, and in many countries output growth remains below potential. Efficiently functioning financial markets are an important precondition for an efficient allocation of capital, thereby contributing to an economy's growth potential.

In many ways, the prospect of EU accession has been instrumental in triggering reform in accession countries, and structural reforms have advanced far enough in these economies to achieve macroeconomic stability. However, there is much that remains to be done. I am confident that the policy-makers in the region will "*hear and listen*" and remain committed to continuing along the path of reform on which they have already embarked.

Ladies and gentlemen, I believe that, with respect to the enlargement of the EU and, later on, the accession of these countries to the euro area, the next few years will be crucial. I will take part in at least most of this process as an observer and no longer as an actor. However, I will continue to watch with great interest how the European Union and, in particular, the European System of Central Banks (ESCB) continues to manage this momentous process.

I should like to conclude by again thanking IMADEC University for the honour it has bestowed upon me. I regard this honorary doctorate as a reward not only for myself, but also for all those - and Klaus Liebscher is one of them - who have contributed to a stability-oriented macroeconomic framework.

Thank you for your attention.