Klaus Liebscher: The Euro – a stable anchor for Europe

Speech by Mr Klaus Liebscher, Governor of the Austrian National Bank, at the Central & Eastern European Issuers & Investors Forum 2001, held in Vienna on 16 January 2001.

* * *

Ladies and gentlemen!

It is a great pleasure for me to join you here at the Central & Eastern European Issuers & Investors Forum organized by Euromoney Forums. I am particularly pleased to have the opportunity to address the current experiences and future challenges of European monetary unification in front of so many leading issuers and investors in the region. In this context, I will mainly focus on three points: on the achievements of the new European currency to date, on the Austrian experience with European monetary integration and on the question of how we can pass on our experience to countries which have applied for EU membership.

Ladies and gentlemen!

Already in its run-up, the concept of EMU led to an impressive process of disinflation and to nominal and real convergence within the EU as well as to a process of consolidation of public finances. Today, the euro is well established, and we are beginning to reap the benefits of the single currency and a single monetary policy: The inception of European Monetary Union in 1999 put an end to exchange rate fluctuations and the resulting economic distortions among the countries of the euro area. The euro has significantly reduced the transaction costs for trade within Europe. It contributes to even more intensive coordination of economic policies within Europe and enables European financial markets to become much more integrated, liquid and efficient. And I am convinced that the changeover to euro cash at the beginning of 2002 will further enhance public support for the euro.

Moreover, the euro has established itself as the second most important reserve currency. The euro/dollar foreign exchange market is the largest in the world and around 40% of international debt securities issued over the past two years have been in euro.

Thus, already after two years of EMU, the euro is already a widespread international currency, second only to the US dollar, and businesses and investors around the world need to take this into account. In addition, more and more countries use the euro as an anchor currency. This applies primarily to those EU Member States that are not participating in Monetary Union yet and to many Central and Eastern European nations – in particular to EU applicants – as well as to those Mediterranean and African countries that orient their monetary policies toward the euro. At present, approximately 50 states use the euro as their nominal anchor currency.

The euro also serves as a catalyst for economic reform. Among other things, the adoption of a single currency means that Member States participating in the euro area no longer have their own national currencies which they can devalue to protect inefficient industries in times of need. Instead, other ways must be found to maintain competitiveness, both within the euro area and internationally. I believe it is no coincidence that policy-makers across Europe are now focusing more than ever on how to overcome the economic rigidities which, in recent years, tended to hold Europe back in terms of economic growth.

Ladies and gentlemen!

But above all, the prime objective of the independent Eurosystem is to guarantee price stability in the euro area. And this is what the Eurosystem, now also including the Bank of Greece after Greece has joined EMU, has done. Monetary policy decisions have been appropriate to the prevailing economic situation. The decisions of the Governing Council of the European Central Bank (ECB) have guaranteed internal price stability. With an average HICP increase of just 1.1% in 1999 and 2.3% from January to November 2000, the euro area has one of the lowest levels of inflation worldwide.

During the last year, the emergence of external upward price pressures and the upswing of the euro area economy have generated some risks to price stability. In a preemptive manner, the Governing Council of the ECB has tightened monetary policy, thus helping to maintain the favorable conditions for sustained, non-inflationary growth with a positive impact on employment. Over the medium term, there are still elements of upward risks to price stability which warrant close monitoring.

Financial markets have developed confidence in the Eurosystem policies, as can be seen from the fact that long-term interest rates in the euro area have remained persistently at, or below, US levels. Therefore, the independent Eurosystem will stick, in a credible manner, both to its prime objective of safeguarding price stability and to its successful single monetary policy according to the specific needs of the euro area. This was clearly the case, when the Governing Council of the ECB did not take any action after the Fed’s surprising interest rate cut by 50 basis points on January 3th, obviously expressing some concerns with a “soft landing” in the US.

Summing up, a lot of progress has already been made. In addition to low inflation, economic growth in the euro area has reached its highest level in a decade and unemployment shows a clear downward trend. Budgets have been fairly consolidated and structural reforms are under way. If this development continues, I am confident that the future of the euro is indeed very promising. Moreover, it may be said that the single currency is the basis for a stable and prosperous economic climate in the euro area, which also has a positive effect both on our neighbours and EU applicant states and for the global economy. The euro was conceived as a tool to promote further European integration and to strengthen the European economy. And it has done so. Thus, the euro is a stable anchor for Europe and the international financial system.

Ladies and gentlemen!

Let me now turn very briefly to Austria’s experience with full integration in the European Union.

Over the past decades, Austria has become one of the leading small open economies in Europe, ranking above average in terms of growth performance. The slowdown in economic growth recorded in the mid-1990s (i.e. between 1993 and 1996) can be traced to the general economic development in the European Union as well as to the adjustment costs resulting from Austria's accession to the European Economic Area and to the EU. In addition, a powerful process of structural consolidation was in full swing and manifested itself in an extraordinarily high number of insolvencies. But from 1998 onwards, annual growth climbed to its medium- to long-term path of 2.5% to 3%. Moreover, Austria was able to augment its share in EU exports to 3.1% by 1999 (1995: 2.9%).

At 3.1%, Austria's unemployment rate was the third lowest in the European Union in November 2000. Youth and long-term unemployment were also kept at comparatively low levels. The employment rate of 15- to 64-year-olds, measured in terms of full employment, is one of the highest in Europe. And the outlook for the labor market remains bright. The favorable economic development, active employment policies as well as the gradual removal of structural rigidities all foster employment. The dialogue between the social partners has certainly facilitated the favorable development of unit labor costs. In the 1990s, Austria's industrial productivity augmented by 5%, the third highest rate among OECD countries, whereas the growth rate of industrial unit labor costs was 5% lower than that of its main trading partners. Moreover, Austria has been more successful than other countries in avoiding the loss of human capital triggered by high joblessness and in utilizing the productive potential of its workforce, which is highly educated by international standards. The extremely low strike rate also reflects the high degree of social stability in Austria, which entrepreneurs consider to be a major competitive advantage.

Summing up, the entry into the EU and the participation in Monetary Union have visibly shaped the Austrian economy. The changeover to EU law and the intense cooperation and communication with EU institutions, together with the process of gradually getting used to the rules of the new and stiffer competition of a single market, have triggered extensive reforms. Accession to the EU generated considerable net welfare effects, that is the cost of offsetting measures was more than compensated by welfare gains. Solid economic growth, an upbeat labor market, stable prices, moderate unit labor costs and high price competitiveness, the consolidation of public finances, growing attractiveness for foreign investors, the traditional monetary stability and social peace have significantly increased Austria's international competitiveness as a business location since its accession to the EU and Monetary Union.

Ladies and gentlemen!

To what extent can our experience - both within the Eurosystem and in Austria itself - be relevant to countries in transition and, above all, to the EU applicant countries in Central and Eastern Europe ?

Basically, European integration was conceived as a project aimed at ensuring peace, stability and prosperity in Europe. This aim is not restricted to Western Europe only. The forthcoming enlargement of the European Union should be seen as the realization of the Union’s longer-term objective of providing a framework for political stability and economic progress throughout Europe, including

Central and Eastern Europe, to overcome the division of our continent. I might put it that way: It has been ten years since the velvet or, in some cases, not so velvet revolutions led to the fall of the Iron Curtain. And the subsequent transition to a market-based economy has not been easy. According to a transition report of the European Bank of Reconstruction and Development (EBRD), only three countries – Poland, Slovenia and Slovakia – have regained pre-revolution levels of wealth. In other countries, the levels of wealth have fallen below that mark by vast margins.

Obviously, there is a consistent need for economic reform in all societies. While transition-specific reforms will sooner or later come to an end, other reforms will never be complete. Constant reform efforts are the key to achieving a path of sustainable high real growth. Maintaining a faster pace of average real growth than in the European Union is a minimum requirement for keeping the catching-up process going in the transition economies. But I am afraid that we have become very selective in our perception of Central and Eastern Europe. We tend to take note only of certain developments and give some good advice. And sometimes I have moreover the impression that we easily fail to appreciate the enormous progress that has already been made in most of the transition countries, especially in those which are most advanced in reforms and transformation.

Ladies and gentlemen!

The policy issues for a smooth further integration of accession countries into the European System of Central Banks and finally into the Eurosystem were recently addressed at the "East-West Conference", organized by the Oesterreichische Nationalbank and the Joint Vienna Institute, and at the high-level "Vienna Seminar on the Accession Process", a specific conference of the Eurosystem held here in Vienna.

I am convinced that the conclusions of these seminars will provide helpful guidelines for the years to come. The main conclusions are:

- Accession countries will need to further advance the process of bringing down inflation rates, while not delaying the much needed relative price adjustments within the economy. Such price adjustments are part of the transition process and of structural real convergence and will typically entail inflation rates that will, for some time, range above those prevailing in the euro area.
- The objectives of nominal and real convergence should be pursued in parallel. Progress in nominal and real convergence will imply an orderly closing of the gap between the accession countries and the euro area economy, both in terms of per capita income and price levels. In order to reinforce each other, nominal and real convergence paths must be properly sequenced and mutually balanced. A fast-track move towards full nominal convergence and, in particular, towards complete monetary convergence could prove counterproductive in the pre-accession period.
- An important element of structural real convergence is the further development of financial services structures, which were practically non-existent when transition started a decade ago. The main tasks are bank privatization, the development of a sound credit culture and the transformation of banks into efficient and competitive financial intermediaries. The three pillars of a functioning banking system are a high-quality corporate governance of banks, a market discipline in accordance with best-practice standards and an efficient banking supervision. In the transition economies, banking supervision should typically be located with the central banks, at least for the time being, as central banks have the necessary funds to perform this task, have established reputation and are, in any case, concerned with systemic risk issues.
- In the field of legal convergence, the strict implementation of EU Treaty obligations, in particular those concerning the independent status of central banks, will be of fundamental importance. Institutional, personal and financial independence are constitutive elements of central bank independence which are not an end in themselves but are instrumental in attaining functional independence. Moreover, great importance should be attached to responsibility, accountability and transparency as a counterpart of independence.
- As I already mentioned before, the euro has become the anchor or key reference currency in most accession countries. However, there is no general guideline for monetary policy strategies and exchange rate policies before EU accession. Different regimes are feasible, as long as they support the nominal and real convergence process. Upon accession to the

European Union, new Member States shall treat their exchange rate policy as a matter of common interest. After accession, although not necessarily immediately, accession countries are expected to join ERM II. The key features of ERM II are that it has stable, but adjustable central rates to the euro for the participating currency, with fluctuation bands of +/- 15% around the central rate, and that it uses a common procedure for major decisions regarding the conditions of (voluntary) participation in the mechanism. ERM II is flexible enough to accommodate the features of a number of existing exchange rate strategies. The clear incompatibilities with ERM II that can be identified already at this stage are the cases of free floating, crawling pegs and pegs against anchors other than the euro.

- Entry into the euro area will be based on fulfillment of the Maastricht convergence criteria. The Treaty establishing the European Community requires strict and sustainable fulfillment of these criteria, which will be applied to future euro area entrants in the same way as they have been in the past.
- The ongoing dialogue between the Eurosystem and accession countries´ central banks will be further expanded. In particular, the Eurosystem - and, of course the Oesterreichische Nationalbank - stand ready to enhance its cooperation activities in all relevant areas, including economic and monetary policy analysis, payment systems, statistics, legal issues and other areas.

Ladies and gentlemen!

Let me conclude by saying that I welcome the conclusions of the European Council meeting in Nice stating that it is time to give new momentum to the enlargement process. The institutional reform work within the European Union has now reached a stage which makes the Union ready for enlargement, and the road map for progressing with the accession negotiations endorsed by the Council in Nice should provide a solid guide. I am pleased to hear that Sweden, now chairing the EU, has the firm intention to speed up this process and to tackle some of the core issues during the first half of 2001.

Against this backdrop, EU applicant countries in Central and Eastern Europe would be well advised to further strengthen their real convergence efforts. Moreover, legal, institutional and structural convergence remains a key issue in the catching-up process in the preaccession period and, in a number of ways, also beyond EU accession. Premature attempts to achieve full nominal convergence could slow progress at the real convergence front and could therefore be ill-advised.

Personally, I am convinced that the preparations for EU accession and, ultimately, accession itself will promote real convergence and will thus help to overcome the existing economic divisions in Europe. Simultaneously, EU enlargement will be beneficial in economic terms for the European Union as a whole. And last but not least, we should always be aware that the enlargement of the European Union does not only follow an economic rationale, but can also be regarded as a milestone in fostering lasting stability, security and peace on our continent.

Thank you very much for your attention.