

## **Klaus Liebscher: The euro - a solid basis for the future of Europe**

Speech by Dr Klaus Liebscher, Governor of the Oesterreichische Nationalbank, at the 3rd YEPP Congress, Vienna, 6 April 2001.

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Ladies and gentlemen!

I regard it a privilege - and pleasure - to share the podium with our Minister of Foreign Affairs, Ms Ferrero-Waldner, who has shown to the Austrian people and to her European colleagues, what true devotion to the spirit of European integration is, also when, at times, the wind blows in your face.

I am very happy about the opportunity to share some views with you on an issue which, I believe, is of paramount importance for our future.

***"The euro is a powerful symbol of European identity and has the potential to consolidate and propel progress towards European integration."***

Ladies and gentlemen,

Let me use the next half hour or so to explore with you why I believe that this statement captures the essence of Economic and Monetary Union and of the euro.

### **1. The euro in the broader historical context of European integration**

Ladies and gentlemen,

As Europe lay in ruins after World War II, the question arose of what was to become of Europe. In his Zurich speech of 19 September 1946, Winston Churchill was mapping out the way forward with his vision of a "United States of Europe". Against the background of the emerging East-West conflict, fast action was called for. Europe was too weak to restore itself. The newly founded Organization for European Economic Cooperation (which was later to evolve into the Organization for Economic Cooperation and Development, or briefly OECD) coordinated the implementation of the so-called Marshall Plan of US aid to European reconstruction.

As the threat of communism was perceived to rise, the United States were actively supporting the (Western) European unification project, hoping to re-establish free democracies and prosperous trading partners in Europe.

Within Europe, the drive for integration was primarily motivated in the desire to remove the risks for future wars. The important goal was to re-establish a working relationship between the Western alliance and Germany, without arousing the fears of Germany's former enemies. It was against this background that Robert Schuman, at the time France's Minister of Foreign Affairs, held a speech on 9 May 1950, which was to enter the history books as the birthday of the European Community. In this speech, Robert Schuman proposed to unite German and French coal and steel production, which was a natural sector to start with, given the strategic importance of these industries for arms production. The crucial achievement of the European Coal and Steel Community was that, for the first time in history, European governments ceded part of their sovereignty, albeit only in a limited and well-specified area, to a joint, supranational authority. This pragmatic, step-wise approach - to pick out a special area and find a common solution for that specific area, leaving other things for later - was to become known as the "Community method" of integration. You can trace this approach up the most recent steps in European intergration and, I would expect, it will continue to form the basis also for the next years to come.

A guiding principle in this context was to become the idea of "political integration through economic integration". Let me elaborate a little bit. Against the backdrop of the rise of the Soviet Union and the outbreak of the cold war, the next obvious areas of integration in the early 1950s would have been a common defence policy, which would, in turn, have required a political union. However, as it turned

out, this was simply beyond what some countries, notably France, were prepared to go along with. So an alternative strategy was needed.

At the conference of Foreign Ministers in Messina on 1 June 1955, it was decided to start negotiations on two further areas of integration. The outcome was the signing on 25 March 1957 of the Treaty of Rome, which established the European Economic Community and the European Atomic Energy Community. Again, integration was carried forward in selected fields - i.e. the establishment of a customs union and a common market, on the one hand, and a joint policy on the sensitive area of nuclear energy.

Ladies and gentlemen,

By now, you will have noticed that European integration does not happen following a once-approved long-term strategy, but happens through a series of initiatives, often represented by outstanding personalities, with periods of stagnation in between. Further important examples of such initiatives, which exert their influence up to now, are the Single Market Program of 1985 and the Maastricht Treaty of 1992.

The European Communities had been experiencing an extended period of economic and political stagnation since the second half of the 1970s, for which the term "Eurosclerosis" had been coined. One of the cornerstones of continued integration at that critical point in time was the Single European Act of 1985. Its principal aim was the completion of the Single Market for goods, services, capital and labor (which are commonly known as the "four freedoms"). The secret of its success was a firm deadline: 31 December 1992. The Single Market Programme provided a concrete goal for the next few years and kept European integration going.

The second example is the Maastricht Treaty of 1992, which scheduled the start of monetary union by 1 January 1999 at the latest. It is no secret that when the Maastricht Treaty was signed, many sceptics doubted whether this project would ever become reality. But these sceptics underestimated the power of a firm timetable, enshrined in the Treaty of European Union, and the joint forces of the European Commission and a number of European political leaders committed to European integration. Despite currency crises and economic recession in the early-1990s, and undeterred by the substantial economic and institutional convergence efforts required by the Member States, EMU started as scheduled on 1 January 1999.

Aside from political considerations, there are also sound economic reasons which made the introduction of a single currency more or less imperative. As the four freedoms of the Single Market were put in place, the far-reaching economic linkages among EU countries were making independent economic policies more and more difficult. In particular, fluctuating exchange rates were regarded as detrimental to internal trade.

It was just a logical step to irrevocably fix exchange rates between the EU countries and introduce a single currency. At the same time a single currency provides a tremendous stimulus for further economic reform and integration way beyond the limits of the single market itself; I will come back on this later.

Ladies and gentlemen,

So far, I have exclusively dealt with the so-called "deepening" of the European Union. In parallel, a continuous process of "widening" in several waves of EU enlargement went on.

The six founding members of the European Union comprised Germany, France, Italy and the Benelux countries. The first wave of enlargement happened in 1973, when Denmark, Ireland and the United Kingdom joined the EC. Following this "northern" enlargement, in 1981 Greece, and in 1986 Portugal and Spain joined the EC on its southern rim. German unification in 1990 implied that the territories of former Eastern Germany became part of the Communities. The hitherto last enlargement wave was in 1995, when Austria, Finland and Sweden joined. As you may know, the European Union is currently conducting accession negotiations with further twelve, mostly Eastern European, countries.

Obviously, any enlargement affects the decision-making within the European Union. As the Union becomes larger, a gradual move away from unanimity decisions in favour of qualified majority voting is imperative to safeguard the efficiency and workability of the Union's decision-making procedures. It is against this background that the Treaty of Nice, agreed in 2000, foresees a number of institutional changes for the European Commission, the Council and the European Parliament. In particular, voting weights in the Council were adjusted to accommodate new EU Member countries. Also the structure

of the European Commission was streamlined. No doubt, the current wave of enlargement will be the largest and most challenging ever.

## **2. Two years of the euro: achievements and challenges**

Ladies and gentlemen,

Let me now zoom in from this broad, long-term perspective on the recent past and the near future of the euro. As you probably know, the so-called Eurosystem, which comprises the European Central Bank in Frankfurt and the national central banks of the euro-area countries, took over responsibility for monetary policy in the euro area on 1 January 1999. This means that all monetary policy decisions are taken at the bi-weekly meetings in Frankfurt of the ECB Governing Council.

The Governing Council comprises the six members of the ECB Executive Board, including the ECB President, and the Governors of the now twelve euro area national central banks. Inter alia, the ECB Council decides on the official interest rates at which banks can obtain liquidity from the central bank.

There are two important institutional features which ensure that price stability will be maintained in the euro area on a lasting basis: First, the Eurosystem is granted institutional, functional, personal and financial independence in the design and conduct of its monetary policy. Second, the Maastricht Treaty unambiguously enshrines price stability as the Eurosystem's primary objective.

To testify about the fulfilment of its Treaty mandate, various mechanisms of democratic accountability have been installed; for instance, the ECB President has to appear regularly before the European Parliament for questions and answers.

There is no doubt that monetary union has - contrary to all sceptics - turned out as a full success. Exchange rates between the participating currencies were irrevocably fixed on 1 January 1999 and the new federal central banking system took over monetary policy. Already a few months earlier, the System had announced a clear definition of its price stability objective, namely an annual increase in the Harmonized Index of Consumer Prices in the area as a whole below 2%. The System also announced details of its monetary policy strategy, i.e. the set of macroeconomic indicators that it would use in assessing the appropriate level of interest rates. Already in its first two years, the Eurosystem has shown that it follows a pragmatic and forward-looking approach in its policy. In April 1999, we cut interest rates by half a percentage point, in the light of the very low rate of inflation and the international uncertainties then prevailing. As economic prospects brightened up substantially from the summer of 1999 and inflationary pressures emerged - not least due to the more than doubling of world oil prices - the ECB responded by a series of interest rate increases between November 1999 and October 2000, which lifted policy rates by a total of 2 1/4 percentage points. Since then, monetary policy has been in a waiting position, given increasing signs of fainting price pressures against slowing worldwide economic growth.

Ladies and gentlemen,

The positive effects of the euro are felt in numerous ways. International financial crises are no longer able to upset intra-European exchange rate relations and trade. Even ahead of the formal start of monetary union, the 1998 international financial crises did not cause any major disturbances in European exchange markets. Recall that, just a few years earlier in the first half of the 1990's, major devaluations of some European partner currencies put "hard currency" countries such as Austria in an unfavorable international competitive position.

The euro ensures that such "monetary shocks" are now a thing of the past. In addition, the euro has unified twelve formerly segmented financial markets into a huge single market for capital, where companies find a broad range of financial services including risk and venture capital at more favourable terms than before. As a result, the euro has also made Europe more attractive as a business location. Enterprises settling down in the euro area operate in a single market of more than 300 million people. For consumers, the euro creates a single market with full price transparency.

At the international scene, the euro is increasingly used as an investment, issuing, reserve and anchor currency. Just to give you some examples: The euro/US-dollar foreign exchange market is the largest in the world, around 30 % of international debt securities are issued in euro and the share of euro-currency reserves held worldwide amounts to some 13 %. Moreover, approximately 50 states already use the euro as their nominal anchor currency. But also trade transactions will over time increasingly

be switched over into euro, thus sheltering European businesses from international currency fluctuations.

Ladies and gentlemen,

For economic policy makers, the euro provides a strong incentive to reinforce economic reform. Let me just quote two examples: fiscal policy and structural reform. As you know, before entering the euro area, a country has to satisfy strict economic convergence criteria. The latter include the observance of limits on the government deficit and debt. Governments strengthened this unique arrangement already ahead of the start of the euro by agreeing on the so-called Stability and Growth Pact. This Pact stipulates, among other things, that Governments commit themselves to achieving balanced budgets or fiscal surpluses over the medium run. In practice, the Stability Pact has so far been taken very seriously, and the majority of EU countries already exhibits budget surpluses. Also Austria has committed itself in its so-called Stability Program to achieve a balanced budget by next year. Let me emphasize: the firm adherence to Stability and Growth Pact is key to Europe's and Austria's long-term attractiveness as a business location, and therefore for growth and employment.

The second example of a policy area, where the euro exerts strong reform pressure, is structural reform. With a single currency across the euro area, divergent economic developments among the euro area countries need to be absorbed by adjustments in goods and labor markets. The more flexible and the faster these markets react to economic disturbances, the better for growth and employment. Economic reforms which aim for such flexibility are thus high on the agenda. European politicians have therefore taken a number of important initiatives in the past three years to foster structural change and adaptability of the European economy.

The so-called "Luxembourg process" calls for employment guidelines to be issued on an annual basis, which recommend actions to raise the flexibility and the skill level of the work force. The "Cardiff process" aims at structural reforms in the product and capital markets by establishing best practice models and benchmarking. Finally, in Lisbon 2000 the European Union set itself the goal to become the most competitive and dynamic knowledge-based economy in the world, inter alia by further liberalisation of network industries and an extension of benchmarking in new policy areas.

Ladies and gentlemen,

To be sure, living with the euro is not just plain pleasure. There is no prize without an effort. Let me just pick out three challenges that I see for the near and medium-term future.

The **first** challenge is the smooth changeover to euro banknotes and coins. Starting on 1 January next year, national banknotes and coins will be replaced with euro-denominated cash. Within two months, this cash changeover will be finalised. From 1 March, national banknotes will cease to be legal tender, in other words shops will then only be obliged to accept euro denominated banknotes and coins as settlement of a liability. Of course, the OeNB will also after this deadline, without any time limit, exchange schilling banknotes and coins into euro. Nobody will lose any money. Naturally, this euro-cash changeover is a huge organisational and logistical project for the central bank, for banks, shops and vending machine operators. Therefore, preparations have been started several years ago, which makes us confident that this changeover will be managed as smoothly as was the start of monetary union on 1 January 1999. But we are certainly aware that also for many consumers, this change should not be underestimated. Not only for elderly people will the switching over to a new unit of account and to the new appearance of cash imply a substantial adjustment effort. Naturally, during the first few days, dealing with the euro banknotes and coins will be as with a foreign currency when traveling abroad: you do not automatically feel whether a price is low or high. But after a certain while and with the daily use of the euro, our perception will soon adjust to the new unit of account. Be also assured, by the way, that we will watch very carefully that the changeover to the euro will not be abused by shops and enterprises to sneak in "silent" prices increases.

The **second** challenge for European policy makers will be a possible major economic downturn, which - as economic history tells us - will sooner or later come. The Eurosystem has already shown right after the start of the euro that it follows a flexible and undogmatic monetary policy approach.

I am convinced that we will cope also with future economic downturns in as timely and appropriate a manner as we did with the recent period of high growth. In the same vein, I am equally confident that European governments will also during times of weaker economic growth stick to their strategy of medium-term balanced budgets and structural reforms.

The **third** challenge will be the European Union's Eastern enlargement. To be sure, EU membership does by no means imply automatic and immediate participation in the euro area. But it is realistic to anticipate that the future new member countries will, after satisfying the Maastricht entry criteria, eventually also join the euro area.

The economic challenge will be to integrate such low- income, high-growth economies smoothly into an area where only one single set of interest rates applies. The institutional challenge will be to ensure that, after further enlargement of the euro area, the ECB Governing Council will continue to be an efficient decision-maker with regard to a single and price-stability oriented monetary policy.

### **3. The euro as a symbol of a European identity**

Ladies and gentlemen,

Let me come to my conclusion. Konrad Adenauer once said *"Die Einheit Europas war ein Traum weniger, wurde eine Hoffnung für viele und ist heute Notwendigkeit für alle.* - The unity of Europe was a dream of a few, grew into the hope of many, and is nowadays a necessity for all." I believe that a similar statement could also be made on the euro. I pointed out already why I believe that the euro has become a necessity. Let me now focus on why it bears, in my view, the hope - and the potential - for helping the evolution of a European identity.

For many European citizens, the European Union is something quite abstract, far-away, with which they therefore - in the depth of their hearts - do not identify. The European Union is faced with the challenge that much of its working is not visible to the public. Who cares - or even knows - that Ministers and officials meet in Brussels every month to co-ordinate policies?

For Europe to become a priority for its citizens, we need to be frequently in touch with it. For this reason, I find the European Union's student exchange programs so vital: they open up young peoples' minds beyond their national borders and show them an immediate area, where the European Union is directly useful for the individual. Similarly, European research projects boost the research Community's awareness of the Union and foster European-wide networks.

The same applies to business and agricultural support programs. All these little puzzle stones increase awareness of the European Union and familiarize us with the thought of being Europeans. This is also why a European Union passport and the free movement of persons within the Union without border controls are so vital: they are visible signs of European integration.

One of the things that we are most frequently confronted with is money. We use money many times a day, money governs all our economic activities. Sometimes, money even assumes a symbolic character that goes far beyond its actual functions as a means of exchange, unit of account and store of value.

Take, for instance, Austria and Germany, where the Schilling and the Deutsche Mark became symbols of reconstruction and economic prosperity in the post-World War II decades. Similarly, the US dollar is a symbol of US economic and political power in the world. In the same way, I believe, the euro is a symbol of European integration and Europe's increasing role in the world.

So, when from January 2002 onwards, you take out a euro banknote or coin to pay the newspaper, you will be reminded that you are a citizen of Europe. And, once you have discovered that the euro is quite a practical and useful thing to have, this might also strengthen your feeling that European integration is a cause worth all our best efforts.

Thank you very much for your attention!