Klaus Liebscher: The European integration: policies towards stability, growth and employment

Speech by Dr Klaus Liebscher, Governor of the Austrian National Bank, to the Bertelsmann Foundation, European Forum Alpbach, Institute for Public Affairs, and the Bruno Kreisky Forum for International Dialogue, Baden, 29 June 2001.

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Ladies and gentlemen,

It is a great pleasure for me being with you this evening and let me first congratulate the organisers of this conference for having chosen a combination of two very important issues for discussion on European integration – labour markets and enlargement. I am pleased to share some thoughts with you from the view of monetary policy.

The two elements of your conference title touch upon both the deepening and the widening of European integration. I may recall that, in the wake of the fall of the Berlin wall, those two dimensions were often discussed as alternative strategies. However, today it seems clear to almost everybody that European integration has to proceed in both directions. The deepening of European institutions and the widening of Europe's geographical extension are not mutually exclusive but rather dependent on each other. Progress in one area does certainly give momentum to the other.

The most important step in the deepening process of European integration – at least to my mind – has been the creation of Economic and Monetary Union (EMU). From a Governor of one of the euro area central banks this statement will certainly not come as a surprise to you.

Although there was some scepticism or even criticism in the run-up to EMU, not only European officials but also many observers outside the area have since confirmed that the transition to EMU was taken successfully – including those observers who were originally very sceptical about the ambitious aims lined out in the Maastricht treaty. And indeed, the list of preconditions for monetary union met in recent years is impressive.

Let me single out just a few of those points, without attempting to gloss over the challenges that lie ahead:

- First and foremost, while inflation has come down to historically low levels we cannot be satisfied with the current inflation performance. At this point it has to be stressed that price stability was not only a precondition of Monetary Union but – even more importantly – is the prime objective of the independent Eurosystem. Thus, the European Central Bank will ensure that medium-term inflation is in line with price stability. We are confident that such a conduct of monetary policy will gain the trust of the public.
- Public finance has improved with the implementation of the Growth and Stability Pact. An increasing number of countries are already recording budget surpluses. However, this amelioration has predominately been due to favourable cyclical conditions and one-off measures, with only modest help from structural changes. What is more, the visible improvement in the average deficit ratio for the euro area as a whole may come to a halt in 2001 as large tax cuts throughout the area are being implemented without due compensation on the expenditure side.
- Unemployment has come down to the lowest levels in a decade as economic recovery has taken hold. Furthermore, labour markets have also become increasingly responsive to growth, which may give an indication of progress with regard to labour market reforms. High rates of turnover in the labour market are a signal that employers enjoy greater flexibility in tailoring their staff numbers to production needs. However, remaining limits to the choice of the most profitable combination of productive factors may still prevent firms from exploiting the full possibilities of new technologies reducing both welfare and employment prospects. Despite the favourable common trend of wage moderation – which increasing levels of inflation may now put under threat – national wage negotiations should further take into account sectoral and regional differences in productivity.

There is no doubt that the single currency has been an important catalyst in stimulating structural reform processes.

Greater commitment of governments to undertake necessary structural reforms can be observed – reforms to render product markets more competitive, to make labour markets more flexible and to make the tax system more supportive to employment and investment. Additionally, several countries are planning to reform pension and social security systems in response to the increasing demographic burdens. Certainly, much more needs to be done, and awareness of the need for structural changes must also rise. In line with this, the Lisbon process for employment, economic reform and social cohesion – to which the Göteborg summit has added an environmental dimension – will surely increase the potential of the European Union.

Some fruits of Monetary Union have already been harvested. Real convergence of interest rates to relatively low levels has given a great impetus to economic growth. Another example is that currency devaluation, which had been an important source of market distortion, is eliminated with EMU. Particularly traditional so-called "hard currency countries", such as Austria has been during the last two decades, were suffering from some elements of "beggar thy neighbour policies". Fortunately, this is a thing of the past.

Still, the euro is rather an abstract notion to most of the citizens since it does not yet exist as a tangible transaction currency. The euro project will receive much more support once the common coins and banknotes have been introduced at the start of next year. The single currency will enhance price transparency and reduce transaction costs, both of which are likely to promote competition and full implementation of the Single Market for goods and services. But the euro will only be able to fulfil this expectations if it is a stable currency strengthened by a determined monetary policy, structural reform and wage moderation.

Last but not least, the introduction of a single currency is not just an economic project. It also carries a political, symbolic and psychological dimension of European integration. While the replacement of national currencies by a pan-European symbol is hardly changing the national identities of the Member States, it certainly helps to promote pan-European thinking. Perhaps one should recall at this point that integration is not only an objective by itself. What is at stake is sustainable economic and social development and ultimately political stability and – without sounding pretentious – peace.

European integration will only be truly successful if it reaches out to the whole of Europe. Again it is the concept of stability orientation that urges us to complete European unification. According to the underlying rationale of enlargement, either we export stability to the accession countries, or we stand to import instability.

If we manage the enlargement process successfully, this will also be conducive to our endeavour to guarantee stability for the whole euro area. Such a mutual improvement is desirable in a very broad sense: political stability, financial market stability, macroeconomic and – in the particular interest of the Eurosystem – price stability.

The enlargement of the European Union to Central and Eastern Europe has arrived at a critical juncture. Accession negotiations with ten Central and Eastern European countries and with Malta and Cyprus have advanced dynamically, especially during the past half year. Difficult chapters – like "Freedom of movement for persons", "Free movement of capital" or "Environment" – have been provisionally closed with some applicants. Furthermore, some of the six "Helsinki group" countries (which started negotiations only in early 2000) have made good progress in catching up, in the accession negotiations, to the "Luxembourg group" countries.

The European Council in Nice opened the door for a widening of the Union, even if it did not fulfil all expectations. Ratification of the new Treaty is proving more difficult than expected – as we experienced quite recently – but it has to go forward, and I am convinced that it will go forward. The new entrants deserve our full solidarity after having been the victims of historically tough luck.

There is no doubt that enlargement will encourage stability, growth and employment in a wider Europe. There is consensus that the accession countries will reap substantial growth and employment benefits from their membership in the European Union. Still, let me add a word of caution in this context: It may take quite a while before new entrants will be in a position to fully harvest these benefits. A fair share of realism is called for to avoid disappointment.

Enlargement will also foster macroeconomic stability in the acceding countries. Economic policy co-ordination and surveillance will surely play a crucial role in making further headway towards price stability, fiscal prudence and stable exchange rates.

I am sure that price stability should be regarded as the primary objective of monetary policy in transition countries, too. However, while steering a clear course towards disinflation, explicit targets of monetary policy should be chosen carefully. Adequate efforts towards stabilization and structural change can reinforce each other and will foster the catching-up process. Structural reforms are the key to long-term success and sizeable resources have still to be devoted to the structural transformation of the production and financial sectors in Central and Eastern Europe. While accession countries will have to shoulder a large share of these burdens, the European Union is committed to support and underpin this process with significant financial means and extensive technical cooperation.

This conference focuses on labour markets and social policies. For a central banker, labour markets and, in particular wage-setting mechanisms, are of crucial importance. Still, I have the feeling that we in the European Union do not know very much about the functioning of labour markets in the accession countries. Without any doubt there is still room for improvement in these countries, and lessons can be drawn from the experience of EU Member States with reconciling economical and social aims – while on the other hand there is evidence that Central and Eastern European labour markets tend to be more flexible, in a number of ways, than those of many Western European countries. For instance, in Austria we discuss (and postpone) greater flexibility of shop opening hours, whereas in some of our neighbouring accession countries they already have this degree of flexibility. If both flexibility and security are important objectives, learning from each other should definitely be a two-way street.

As you surely know, the accession countries will first join the European Union and only later adopt the euro, after the sustainable fulfilment of the Maastricht convergence criteria. Retaining a reasonable degree of labour market flexibility will certainly be helpful to bring about eventual full monetary integration of accession countries. To be sure, this is not a plea for full deregulation. Rather, I would commend to adopt a broadly liberal stance with selective regulation in areas where it is needed. Moreover, and this comes from my Austrian experience, it should not be overlooked that the social partners can play a constructive and, indeed, beneficial role in labour market and social policies.

I have sketched a number of challenges that European integration is currently facing. Political will and leadership will be required for mastering these tasks effectively. Much is at stake, for the current European Union and for the accession countries alike. I am convinced that the Eurosystem will play its role in the process: We will make the euro a success by both unveiling and increasing the economic potential of the Monetary Union.

Given the stability-oriented framework of EMU, combined with the determination of the independent Eurosystem, the euro will be a stable and attractive currency. Alongside, the European stability zone will gradually expand to more and more European countries, both incumbents and prospective EU Member States. It will be a key task for the Eurosystem to manage this process properly, in particular in terms of speed and timing.

Thank you very much for your attention.