Willem F Duisenberg: The introduction of the euro, the regions and the accession process

Speech by Dr Willem F Duisenberg, President of the European Central Bank, at the plenary session of European Union Committee of the Regions, Brussels, 14 November 2001.

*   *   *

Ladies and gentlemen,

It is a pleasure for me to be here today and to address the plenary session of the Committee of the Regions. Like many events in the still young life of the euro and my institution, the European Central Bank, this is in fact a premiere. In recognition of the composition of this Committee and its specific expertise, I should like to focus my remarks on two key issues, which – I believe – could be of particular relevance to regional and local authorities. First, I should like to explore an issue that has received a great deal of academic and media attention, and which could be considered particularly relevant from the perspective of regional and local authorities: the persistence of regional economic differences in relation to a single monetary policy in which – so to speak – one size fits all. Second, allow me to address some of the challenges connected with the forthcoming enlargement of the European Union and the eventual entry of the new Member States into the euro area.

But before doing so, let me emphasise that the introduction of the euro banknotes and coins is – at the moment – the most important challenge for the ECB and the national central banks (NCBs) of the euro area. The euro banknotes are currently being produced by 15 different printing works throughout Europe, including those of a number of NCBs. By the end of October 2001 over 13 billion banknotes had been produced – that is, significantly more than the 10 billion expected to enter circulation at the beginning of next year. The printing works are currently producing logistical stocks for the purposes of the changeover.

In order to ensure the smooth introduction of the euro banknotes and coins and the efficient withdrawal of national banknotes and coins, the logistics of the 2002 cash changeover have been determined well in advance. Within this general framework the changeover scenario is a national responsibility, in accordance with the principles of subsidiarity and decentralisation.

The Eurosystem is well aware of the importance of achieving a smooth cash changeover in order to maintain both public and financial market confidence in the single currency. One of the main concerns expressed about the cash changeover is the need for retailers to hold large amounts of cash during the first few days of 2002. In order to address this concern, a substantial number of measures are being implemented at the national level.

While a successful cash changeover is an immediate concern – and thus naturally at the centre of current public and media attention, – we should also bear in mind some of the longer-term challenges involved in making Economic and Monetary Union and the euro a lasting success. In this context, the relationship between the single monetary policy and the presence of regional economic differences in the euro area is probably of particular relevance and, in my view, also a topic of common interest to our institutions.

The Treaty establishing the European Community unambiguously lays down that the overriding objective of the single monetary policy is to maintain price stability in the euro area. This reflects the notion that the best contribution that monetary policy can make to sustainable long-run economic growth and rising standards of living is to maintain price stability.

A single monetary policy which is successful in fulfilling this objective will not necessarily imply that euro area regions or countries will always display similar price developments. Divergence in price developments across various regions or countries is a *normal phenomenon* in monetary unions. Such differentials in price developments represent relative price changes, which do not affect – and are not affected by – monetary policy.

Given the existence of a *single* monetary policy in the euro area, the ECB's monetary policy can only have an impact on the price level for the euro area as a whole. This is true irrespective of the number of countries or regions that are part of the euro area. This implies that the ECB's monetary policy must focus on price stability in the euro area as a *whole*.

However, it is important to understand the sources of differentials in the rates of price changes among countries and regions in the euro area, since they may affect citizens' welfare and require national or regional corrective measures.

One source of divergence in the rates of price changes across euro area countries or regions, which is often quoted in public debates, relates to the “catching-up processes”. We can witness such a catching-up process when a country or a region starts from a lower level of productivity – and thus income per capita – compared with other economies participating in EMU. During the transitional period, there may be faster productivity growth in sectors exposed to international competition in the catching-up economies than in the more mature economies. This, in turn, might be associated with faster price increases in the catching-up economies. This is a normal phenomenon within a monetary union and is not in itself a cause for concern. In this respect, I should like to stress that a substantial process of convergence in per capita income has already taken place in the euro area over the last few decades.

Another source of divergence in the rates of price changes across euro area countries or regions may arise when countries or regions are affected by economic or policy shocks which are different in their nature or timing, or when, due to different economic structures, local economies respond differently to a common shock. One example of this would be a change in the oil price. Although this is a common shock to the whole euro area, countries and regions in the euro area can be affected to a different extent, depending on their particular demand for (or supply of) energy.

As differences in economic structures across countries are likely to remain in the future too, the fact that different regions in the euro area will face different economic shocks will be unavoidable. It is therefore crucial that national and local authorities have all the measures in place to facilitate a smooth and efficient adjustment to economic developments that affect countries and regions differently.

One important equilibrating mechanism in response to such shocks is fiscal policy, through the operation of automatic stabilisers and the adoption of specific measures in the case of adverse shocks at the regional and national level. However, this requires sound budgetary positions over the medium term in accordance with the Stability and Growth Pact. In this context, allow me to emphasise the responsibility of regional and local authorities to make an important contribution to the consolidation of public finances by exercising control over public expenditure.

Another important adjustment mechanism is mobility in the factors of production. The process of European integration has already led to a significant convergence of financial and capital markets and capital is now highly mobile at the international level. However, labour continues to be barely mobile within many euro area countries and almost immobile between countries.

To this end, it is crucial – and I should like to encourage you – to make as much progress as possible in the introduction and acceleration of structural reforms aimed at increasing mobility, promoting flexibility in price and wage settings, enhancing competition and reducing distortions in product and labour markets. Without these reforms, the loss of competitiveness deriving from rigidities will become a source of national, or regional, unemployment and inefficient under-utilisation of resources. Stronger competition and the removal of structural rigidities will increase the flexibility of the economy and lower the adjustment costs associated with asymmetric shocks affecting one particular country or region. Although considerable progress has been made, much remains to be done.

Ladies and Gentlemen, allow me to also stress the importance of your role in contributing to informing European citizens about the dangers caused by divergences in price developments across countries or regions, which might arise as a result of excessive wage increases or the unsustainable expansion of profit margins at the local level. The more such developments become entrenched in the economy, the more they will lead to a loss in competitiveness and, eventually, to a loss in output and employment in the respective economies.

Clearly, our efforts to make the euro a success will require all of us to master – at home – the challenges which I have outlined. However, the European Union, and also the euro area, face an important external challenge – and this brings me to the second topic of my presentation: the EU accession process and the subsequent enlargement of the euro area. The fact that your Committee has established a liaison group with applicant countries bears witness to the substantial implications which enlargement will have not only for a central bank but also for representatives of regional and local authorities.

As you are well aware, to date 12 countries from central, eastern and southern Europe are involved in negotiations to become members of the EU and, ultimately, also of the euro area. The integration of such a large number of new countries into the European Union – which would imply almost a doubling of the current number of Member States – will be an enormous task for both sides and be without a precedent in history.

As I have just said, accession to the EU also entails significant implications for the economies of the accession countries themselves. For them, the main priority is indeed to foster the convergence process with the EU, both in real and in nominal terms. Thus, accession countries are aiming to achieve the European Union's standard of living, while at the same time seeking macroeconomic and financial stability. This process will entail profound and comprehensive adjustments in their real economies as well as in the careful design of sound economic policies.

Undoubtedly, significant progress has already been made in this respect. A substantial reallocation of resources, a strong reorientation of trade links towards the EU, a complete institutional overhaul and a sizeable development of the private sector are the most obvious signs of systemic change. However, these achievements should not give rise to complacency but rather be taken as motivation for further structural reforms. These reforms are needed in accession countries in order to further transform their economies into fully-fledged market economies, so as to enable them to cope with competitive pressures and provide the conditions for sustainable and non-inflationary growth. Given the positive impact of structural reforms on those countries' disinflation processes, there appears to be no contradiction between real and nominal convergence. Thus, both objectives should be pursued in parallel and the emphasis should not be focused on one target at the expense of the other.

In the context of real and nominal convergence, I should like to emphasise the important role played by sound fiscal policies. Although we judge the overall fiscal policy stance as being broadly satisfactory in most accession countries, budgetary consolidation efforts in some countries appear to have experienced a recent setback. In these few cases, a strengthening of efforts to return to the path of sound fiscal policies is crucial. A determined pursuit of fiscal consolidation is all the more necessary as the accession process and the completion of the transition phase are likely to place further demands on the budgetary situation, for example in relation to higher infrastructure investments or future reforms of the accession countries' health and social security systems.

Ladies and Gentlemen, I should like to conclude my presentation by answering one of the main questions which usually arises when a representative of the ECB talks about enlargement: will the accession process have consequences for the conduct of the single monetary policy? The answer is no. As I have already argued with regard to the issue of monetary policy and regional differences, the ECB's monetary policy can focus only on maintaining price stability in the euro area as a whole, irrespective of the number of regions or countries forming part of the euro area. Furthermore, the definition of price stability, as adopted by the ECB, should be seen as a lasting quantification of its primary objective. The purpose of a definition is that it should remain valid as a consistent and credible point of reference over time and in different circumstances.

Ladies and gentlemen, it has been a pleasure to be able to use this brief presentation to convey the perspective of a central bank on topics that are also of great interest to the Committee of the Regions.

Thank you very much for your attention.