

Willem F Duisenberg: The ECB and the accession process

Speech by Dr Willem F Duisenberg, President of the European Central Bank, at the Frankfurt European Banking Congress, Frankfurt, 23 November 2001.

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Ladies and gentlemen,

Let me first thank the organisers of this Frankfurt European Banking Congress for giving me the opportunity to address such a distinguished audience. Today I would like to share with you a few thoughts about the process of EU accession from a central banker's perspective, and review some of the issues that are of particular relevance to the ECB.

Little more than ten years after the beginning of the transition to market economies in Central and Eastern European countries, the successful model of European integration is in the process of being extended. This testifies to the attractiveness of the European Union as a sound framework providing both political stability and economic progress. In a few weeks' time, on 1 January 2002, a new milestone will be reached when the euro, our money, becomes truly tangible. The introduction of the euro banknotes and coins indeed constitutes a historic event in the process of European integration, and represents a key accomplishment in the already long European experience. The changeover comes as we approach a situation in which inflation should fall below 2% and price stability should be restored. In line with our forward-looking strategy we have cut interest rates on the basis of reduced risks to price stability. Recent data are in line with expectations and confirm our decision of 8 November which took account of all relevant information.

As President of the ECB, I would like to confirm that the euro will indeed eventually "go east". As many as 12 countries from central, eastern and southern Europe and the Mediterranean are currently negotiating accession to the EU. They have made remarkable progress, both in negotiations and in strengthening their economies and policy-relevant institutions. However, the road towards EU membership and, later, the adoption of the euro still poses a number of significant challenges.

What are these challenges? Let me focus briefly on three economic areas in which notable differences still prevail between accession countries and EU Member States: first, real convergence, second, nominal convergence and, finally, the structure and functioning of the financial sector.

By "real convergence", I mean the broad adjustment through structural reforms and economic development of the economies towards structures prevailing in the EU. This requires, inter alia, the completion of the market economy transition agenda, further privatisation in some sectors, and the strengthening of the institutional and legal framework. Real convergence is seen as facilitating economic cohesion among Member States once they have joined EMU, thereby helping to minimise the risk and effects of asymmetric shocks. Hence, in order to enhance the process of real convergence as much as possible, accession countries should ensure that they make progress in the restructuring of their economies and gradually align them with those of the euro area. Real convergence is often interpreted as a catching-up in real income with the EU. Such a narrow measure is, however, only a rough proxy for the concept of real convergence I was referring to. Indeed, different income levels can be compatible with Monetary Union, as we know from our own experience in the euro area.

As for nominal convergence, accession countries have achieved a remarkable process of disinflation during the last decade. Inflation is expected to reach around 6% on average by the end of this year. Nevertheless, further progress on disinflation might turn out to be more complicated in the coming years. First, several macroeconomic and microeconomic factors as well as transition-related factors will continue to push up inflation in many accession countries. Second, what is known as the "Balassa-Samuelson effect", that is, the potential inflationary pressures arising from higher productivity growth in catching-up economies, has also been held responsible for higher inflation in accession countries. However, research has shown that this effect should not be overestimated. These factors should be borne in mind when designing monetary policy strategies. In this context, disinflation in accession countries should be promoted, at a pace determined by the overall economic situation and in particular by the need for these countries to foster real convergence. In addition, the Maastricht inflation criterion should not be regarded as an immediate requirement, but rather as a medium-term objective for the central banks of the accession countries. This should not mean, however, that

accession countries do not have to pay attention to progress in nominal convergence. On the contrary, a balanced monetary and fiscal policy stance and wage increases supported by productivity gains should favour the disinflation process of accession countries, and allow them to make progress on nominal and real convergence in parallel.

As a specific topic that is of great relevance to the ECB in the accession process, I would like to mention the structure and functioning of the accession countries' financial sector. Significant progress has been made in restructuring and consolidating the banking sector over the past few years. This progress has been achieved through the large-scale privatisation of state-owned banks and the extensive opening-up of the banking sector to foreign ownership. This process has contributed to greater financial integration with the EU and significant gains in terms of efficiency and stability. However, the level of financial intermediation remains relatively low and the provision of bank financing represents a much smaller share of GDP in the accession countries than in the euro area countries. Furthermore, the financial sector of accession countries remains dominated by the banking industry, as capital markets are not yet fully developed. From an ECB perspective, further deepening of the accession countries' financial markets is needed to ensure the proper transmission of monetary policy impulses once they join the euro area, and it may also help these countries make full use of their growth potential.

Coping with any of the three challenges which I have just mentioned will have a significant impact on the design of monetary and exchange rate policies. Taking into account the different starting points and progress made so far in addressing these challenges, accession countries may well pursue different approaches in the pre-accession phase. Once in the EU, however, there is a clear path defined in the Treaty that should be followed by all EU Member States towards the adoption of the euro.

First, immediately upon EU accession, the new Member States have to treat their exchange rate policy as a matter of common interest. Furthermore, in view of the final objective of adopting the euro, accession countries are expected to join ERM II at some point following accession to the EU.

Most accession countries have already expressed their intention to join the mechanism as soon as possible after their entry into the EU. However, it should be clear that ERM II membership does not need to happen immediately after EU accession in all cases, nor does ERM II membership need to be limited to only two years, which is the minimum for adoption of the euro. A longer membership of ERM II may, in some cases, be helpful since it would allow countries to retain the exchange rate as an instrumental policy variable during the catching-up process. Participation in ERM II should thus be seen as a meaningful and flexible framework for increasing convergence with the euro area, and for tackling the challenges faced by accession countries on the road towards the adoption of the euro.

Finally, after having outlined the path along which the euro will go east, I would also like to say a few words about a path which I am confident will not be followed – and that is unilateral euroisation. Such an adoption of the euro outside the Treaty process would not be welcome as it would run counter to the important process of convergence prior to the adoption of the euro outlined in the Treaty. Unilateral euroisation would also imply circumventing the process of multilateral assessment of new members by current EU Member States and as such would be difficult to reconcile with the co-operative spirit of a community of fellow members. From the other perspective, I believe it would also not be in the interest of accession countries, as it would imply relinquishing monetary and exchange rate policy instruments at a very early stage of convergence for these economies. It would further deprive the countries concerned of a lender of last resort function and non-negligible seignorage revenues. Finally, it would make the integration of the central banks concerned into the Eurosystem operational framework much more difficult, if not impossible.

Ladies and gentlemen, I should like to end my remarks here by saying that the Eurosystem is fully aware of the future implications of the ongoing accession process for the fulfilment of its own statutory objectives. As the historic process of reunifying Europe unfolds before our eyes, let me assure you that the ECB is ready and looking forward to playing its part.

Thank you very much for your attention.