## Klaus Liebscher: The euro - an anchor of stability in the international financial architecture

Speech by Dr Klaus Liebscher, Governor of the Austrian National Bank, at the International Financial and Economic Forum, Vienna, 14 November 2002.

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It is a pleasure for me to be with you today and to address this highly distinguished audience on the euro and its role as an anchor of stability in the international financial architecture.

Since March 1st of this year, euro banknotes and coins have been the sole legal tender in as many as 12 out of the 15 Member States of the European Union, i.e. for as many as 300 million people. The completion of monetary integration in those 12 countries, as mapped out in the Maastricht Treaty, truly represents a culminating point in the process of European integration. With the use of euro cash, the single European currency has finally become a tangible reality for the citizens of the euro area - part and parcel of their everyday lives. It is gratifying to note that this historic cash changeover was completed most successfully with the broad - and often enthusiastic - support of the European citizens, including the people of Austria, of course.

With the introduction of the euro, the economic weight of this single market has risen to a level matching that of the USA. Thus, the single currency has gained an important international dimension. The number of principal actors in the international financial system has now been reduced to three - the USA, Europe and Japan. At present, Europe is still trying to find its own, distinguished voice in international financial matters. But it is a fact even now that the introduction of the euro has had a stabilizing influence in the international financial system, as was successfully demonstrated in the wake of September 11, 2001.

A number of indicators point to the growing international role of the euro: The euro segment of the global money market has risen to about 25%. In the bond market, too, the euro plays a crucial role in fostering a deeper and more liquid market. The introduction of the euro paved the way for issuers to access a broader base of investors. Investors too have gained access to a wider spectrum of investment opportunities. The euro’s share in net issuance currently amounts to 39%. Regarding its use as an official reserve currency, the euro has already attained the same weight as the predecessor currencies.

Within the euro area, Monetary Union has kept member countries from being exposed to harmful intra-European exchange rate tensions of the type that many countries used to suffer when external shocks occurred. It has become quite obvious that Austria's inclusion in the stability-oriented Economic and Monetary Union has protected our country from negative shocks much more adequately than was possible under past regimes. Moreover, the almost four years of EMU bear impressive testimony to the fact that the stability-oriented interplay between monetary and fiscal policy provides a solid foundation which was well suited to weathering the economic policy challenges of this period.

The stabilizing effects of the euro, however, go beyond providing an anchor in the exchange rate regimes of not only EU accession countries but, all in all, about 50 countries within the gravity zone of the euro area. By providing price stability the euro contributes towards more stability in the international financial system.

The goal of maintaining price stability over the medium term lies at the core of the independent Eurosystem’s monetary strategy. After almost four years of EMU we can observe that the Eurosystem has to date performed very well in preserving price stability. The euro area has achieved low inflation and low interest rates, which should stimulate further investment and contribute to sustainable growth in the euro area.

In order to ensure stability, the institutional framework of EMU extends beyond monetary policy. A key ingredient is the Stability and Growth Pact, which intends to promote sound fiscal policies at the level of individual member countries. By fostering fiscal discipline, it contributes substantially to the non-inflationary growth potential of the euro area. Prudent fiscal policies reduce the debt-to-GDP ratio and, consequently, the interest burden on governments; they increase investors’ confidence in the euro area, keep interest rates lower than they would otherwise be, and lead to a crowding-in of private investment.

Therefore it is essential that all member countries remain credibly committed to the framework of Treaty and the Stability and Growth Pact. In this regard, it is important to recall that fiscal targets should embody sufficiently ambitious structural consolidation efforts and should also be based on realistic growth assumptions.

Thus, the current economic slowdown should not distract governments from pushing ahead with reforms related to the size and structure of public expenditures and revenues, taking into account the need to create room for tax cuts and to absorb the cost of an ageing population.

Apart from fiscal policy, further structural reform is another improtant ingredient for the success of EMU, especially in the longer term. Structural reform is needed both for its indirect effects on monetary policy via the budget, and for its direct effects on the international competitiveness of the euro area. Competitiveness includes, among others, increasing the flexibility of the labor and product markets and creating a more efficient tax system that encourages job creation.

As a stable anchor for Europe the euro contributes to the stability of the international financial system. As the financial system is crucial in the allocation of resources by channeling funds from households to enterprises, an economic environment in which these functions can be fulfilled smoothly and efficiently is essential for the welfare of an economy. Financial markets can only work smoothly and efficiently if they can rely on a complementary legal and regulatory infrastructure. Thus, the economic integration of financial markets has to be accompanied by the necessary adoptions of regulatory frameworks and regimes.

In today’s globalized world there is no doubt about the importance of a strong and well-regulated financial sector. The crises that have swept a number of emerging markets in recent years indicate the dangers that a weak financial sector poses to economic stability. Therefore, the international community has set a range of initiatives to strengthen the international financial architecture. After all, global financial stability needs to be promoted through both national action and enhanced international cooperation.

In the international arena, the IMF has played a central role in the effort to establish internationally accepted standards and codes as "rules of the game" for the global economy. The IMF and the World Bank have worked together with central bankers and regulators to develop the "Financial Sector Assessment Program" as a systematic way to identify weaknesses and sources of vulnerability in national financial sectors. It is designed to help countries to enhance their resilience to crises and cross-border contagion, and to foster growth, by promoting financial system soundness and financial sector diversity. Austria has declared its interest to participate in this program and will thus have its financial sector systematically monitored with respect to its resilience to shocks.

Let me next turn to the debate about the European regulatory framework. By abolishing national boundaries and harmonizing different legislations, European integration has fostered the development of a single financial market in Europe.

The introduction of the euro, the single monetary policy, the existence of a single payment area all have undoubtedly accelerated and reinforced the process of financial market integration and structural change as well as the growing process of European financial and banking integration.

However, in the recent past the speed of integration has slowed down. As a case in point, all those structural factors that the Eurosystem some time ago identified as hampering further financial market integration are still in place. This is regrettable since the degree of financial market integration in Europe is still clearly below the level efficiency considerations would suggest. The national economic policies of the EU Member States are a big obstacle to further integration; in other words, a great number of regulatory, tax and legal barriers continue to impede stronger financial market integration.

But the current regulatory and supervisory framework still strongly relies on national responsibilities. The Brouwer Report found that there is a need to enhance arrangements for cross-border and cross-sectional co-operation, to improve the alignment of supervisory practices and to reinforce the collaboration between supervisory and central banking functions.

The EU’s regulatory roadmap to integration is the Financial Services Action Plan. It contains more than 40 legislative and non-legislative measures. The deadline agreed by the European Council for implementing the entire Plan is 2005, with an earlier deadline of 2003 for the securities and risk capital markets.

Considerable progress has been made in recent attempts to implement the Lamfalussy recommendations in the field of security market regulation. Consistent and efficient implementation of regulatory rules has been promoted by new institutional arrangements delegating rule-making powers to a committee or regulators whereas implementation at the national level is undertaken through a committee of supervisors.

These two examples illustrate that initiatives are under way and debate is ongoing. However, not all of the recommendations of the Brouwer Report have been implemented and many other issues still need further investigation and debate. But developments show that we are heading in the right direction.

The increasing integration of the European financial markets is only one further example that economic policy has become a subject of common interest in the European Union. It also requires putting financial stability in an EU-wide perspective alongside the still important national point of view. Accordingly, enhanced cooperation in the field of financial supervision, both nationally and between EMU Member States, can minimize the risks involved in deepening of financial market integration so that its indisputable advantages can take effect.

At the national level we have been observing various proposals to reorganize and restructure financial markets supervision. In Austria, the legal foundations as well as the practice of supervision have been evolving rapidly to respond to developments in the financial sector, to implement the EU financial sector directives, and to introduce ongoing improvements in international best practice.

The most visible change in supervision and regulation has been the establishment of a single financial supervisory agency. Since April 1st, 2002, the Financial Market Authority performs banking, securities, insurance and pension fund supervision. The Financial Market Authority is autonomous. It operates independently and is not bound by any instructions. The restructuring was aimed at establishing a high-quality, effective and at the same time cost-efficient supervisory regime.

Given the Oesterreichische Nationalbank’s far-reaching operational integration in banking and financial market supervision, the Austrian central bank can fulfill its manifold macroprudential tasks also within the Eurosystem and can thus contribute to safeguarding financial stability. The close involvement of central banks in the supervisory process has various advantages. It gives the central bank a much clearer picture of the economic reality that is behind the numbers visible in the books of banks.

This information facilitates its role in safeguarding financial stability and creates a special advantage in spotting early warning indicators of financial crises and potential situations of economy-wide financial distress. Moreover, as a part of the Eurosystem central banks are integrated in an already functioning network of national and supranational institutions. Such a network is of decisive importance in the light of the structural change in European financial markets that already has taken place or is likely to come in the near future.

After successfully implementing EMU, the next major task Europe faces in the upcoming years is certainly the enlargement of the European Union. This integration project is just as impressive and far-sighted as EMU, and it offers both enormous opportunities and challenges that should not be underestimated. I am firmly convinced that a diligently prepared enlargement of the EU will go down in European history as a very major step toward integration and peacekeeping.

European integration will only be truly successful if it reaches out to the whole of Europe. It is the concept of stability orientation that urges us to complete European unification. 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.