Erkki Liikanen: Independent institutions and rule of law are essential for successful convergence

Speech by Mr Erkki Liikanen, Governor of the Bank of Finland, at the 7th ECB conference on central, eastern and south-eastern Europen (CESEE) countries "Institutional quality and sustainable economic convergence", Frankfurt am Main, 5 October 2017.

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First a comment from the history of enlargements.

The first post- cold war – enlargement negotiations started in March 1993. These were concluded in spring of 1994. Austria, Finland and Sweden joined in January 1995. I was one of the negotiators then.

In the middle of these negotiations, in June 1993, the Danish presidency hosted **Copenhagen European Council**. The Council wanted to show the path to 10 Central and Eastern European countries who desired to become a member of the EU.

The Summit defined three key pillars, preconditions for the membership:

The membership requires:

1. the candidate country has **achieved stability of institutions guaranteeing the rule of law, human rights and respect for and protection of minorities**
2. the existence of a **functioning market economy** as well as the capacity to cope with competitive pressure and market forces within the Union
3. **the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.**

In the summit in Essen in 1994 the Pre-Accession strategy was confirmed and it turned out to be very successful.

Four years later, in July 1997 the European Commission assessed the candidate countries in her opinion. This opinion was a pre-condition for membership negotiations. I was a member of that European Commission.

The first chapter of the Commission opinion analysed the political criteria with the Title **Democracy and the Rule of Law**. The Judiciary, its structure and its functioning got a particular attention.

It is no surprise to anyone that these issues remain a corner stone in the European Union. When joining the EU, the countries took the commitment to respect these principle. It is also very important that European Commission monitors the developments closely and takes also actions, when needed.

The enlargement negotiations were launched in March 1998 in Brussels.

W e **can all agree that economic convergence in the CESEE countries has been a success.** With the help of foreign investment and especially market access to the European Union, countries in the region have been able to lift their incomes significantly.

For example, during the past 25 years real per capita gross domestic product in **Hungary** and the **Czech Republic** increased by approximately 80% – very rapid increase in welfare. Some countries did even better: **In Poland** and **Estonia** corresponding increase in economic welfare was approximately 170%. Research from the EBRD shows that the countries that joined the EU have also been better in ensuring that growth is inclusive.

Rapid economic growth in the region, integration with the older EU countries and convergence towards them has been an economic success story for the whole continent, **showcase example of economic reforms yielding benefits that can be and are shared widely.** Many EU member countries that joined in 2004 are now integral parts of EU-wide production networks. I was happy to witness the arrival of the new member states and also new members to the European Commission 1.5.2004 before moved to the Bank of Finland and to the ECB Governing Council in July of the same year.

As we celebrate these achievements, we need to remember their prerequisites. Global economy is full of sad examples of countries failing to catch up, failing to improve welfare of their citizens. **If institutions are not stable and credible, and if the rule of law is not respected, then it is not possible to attract investments and not possible to ensure sustainable economic convergence in the longer term.**

In this regard performance of the countries in the region was helped by the European Union, which was the anchor. It offered both economic assistance and also a model of democracy, which respected rule of law and separation of powers.

While this model of independent institutions and rule of law has been successful, many see it now challenged in various parts of the world, and the issue is not unknown here, either.

Every country and every nation has her right to choose their political leaders and political tendencies. **But membership in the European Union, which is based on common values and respect of the rule of law, brings also its obligations.** The question is: How to preserve the rule of law, how to preserve independence of public institutions, including central banks and financial supervisors, from undue political influence?

Economic literature and history tell how important the role of institutions is for sustainable economic growth. Countries that are able to share increasing prosperity and, for example, ensure education opportunities are better placed to uphold functioning institutions in the long-run.

However, countries with good economic performance are not immune to temptations of various degrees of populism. One type of populism is that establishment and the forces in power is challenged. This is a challenge everyone in power must accept and can be a healthy warning. But if it takes a form where pluralist democracies and independence of institutions and rule of law are questioned, the situation can become very serious.

Then resilience of the rule of law and independent institutions can be tested. In the long-run such tensions within societies, especially if they persist, can be detrimental to economic development. Moreover, damage to the cohesiveness of a society may be hard to repair after such periods.