

Mr. Liebscher discusses the role of a national central bank within the ESCB as illustrated by the OeNB Address by the President of the Austrian National Bank, Dr. Klaus Liebscher, held at the 26th Economics Conference of the Oesterreichische Nationalbank on the topic “Economic Policy 2000”, in Vienna on 7-8/5/98.

Introduction

Just a few days ago, the key political decisions which will pave the way to EMU were taken at the summit in Brussels. Based upon the preparatory work of the European Monetary Institute, the Commission and ECOFIN, the Council of the Heads of State or of Government agreed last weekend to start Stage Three of EMU on January 1, 1999, with eleven countries. At the same time, the bilateral exchange rates for the participating currencies, which are to form the basis for their euro conversion rates, were preannounced. The European Central Bank will be formally inaugurated in Frankfurt on June 30, and EMU will commence on schedule on January 1, 1999. These developments have provided the financial markets with reliable points of reference that will contribute substantially to a calculable development of exchange rates and interest rates until the onset of EMU.

The general public and the financial markets are now convinced that EMU will become reality in just a few months' time. By comparison, people know much less about the institutions that will be responsible for the single monetary policy and, in particular, about the relationships among them. Will there still be a place left within EMU for today's national central banks? And if so, which tasks are they going to keep once monetary policy is made in Frankfurt? These are questions that are frequently asked. And the answers are indeed quite complex.

The basic institutional framework of the European System of Central Banks as defined in the ESCB/ECB Statute

A superficial glance at the ESCB/ECB Statute lets things appear quite simple.

- The establishment of the ECB in mid-1998 will coincide with the foundation of the European System of Central Banks (ESCB). The ESCB will consist of the ECB and the national central banks (NCBs) of the EU member states. From January 1, 1999, the ESCB will have the sole responsibility for the single monetary policy within the euro area. In performing its tasks, the ESCB will be independent of any political instructions and will be committed to the primary objective of price stability.
- The ESCB will be governed by the ECB's decision-making bodies, led by the ECB Governing Council, which will consist of six members of the ECB Executive Board, including the ECB President and Vice-President, as well as the governors of the NCBs of the euro area. Monetary policy decisions will be

taken centrally, by a simple majority of the ECB Governing Council and based on the principle of “one member, one vote”.

- The ECB Executive Board will conduct monetary policy in accordance with the guidelines and decisions adopted by the ECB Governing Council. In doing so, it will issue the necessary instructions to national central banks.
- The national central banks will form an integral part of the ESCB and act in accordance with the guidelines and instructions issued by the ECB. In conducting operations within the ESCB’s field of competence, the ECB will rely on the national central banks whenever possible and appropriate.
- Finally, a so-called “General Council” will be constituted as a third decision-making body. It will assume responsibility for the coordination and exchange of information between the euro area and EU central banks which have not yet adopted the single currency, but will not exercise any influence on the monetary policy of the euro area.

Ample room for manoeuvre in practical implementation

This, in a nutshell, is the ESCB/ECB Statute. Its apparently quite straightforward structure allows ample room for manoeuvre in actual practice. The European Monetary Institute in fact devoted quite a substantial part of its preparatory work on EMU to the concrete assignment of duties and the establishment of procedures within the ESCB.

Let me just quote a few examples of questions that had to be resolved in compliance with the ESCB Statute: Who within the ESCB will conduct monetary policy operations? Who will intervene in the exchange markets? Who will manage the foreign exchange reserves? Do we, inside the euro area, still need national balance-of-payments statistics? Where will the commercial banks keep their central bank accounts? Which bodies within the ESCB are to have access to the TARGET cross-border payment system? Who will issue euro banknotes? Who will print them? Where does the monetary income from the creation of central bank money originate: at the ECB or at the national central banks? And how is it going to be distributed within the ESCB? Who will prepare the documents for the meetings of the ECB Governing Council? Will there still be committees of experts delegated by the national central banks to at least help prepare the decisions of the ECB Governing Council? How large should the ECB be by comparison to the national central banks and how much staff will it need?

Each of these questions – and here I have picked out just a few – has been discussed by the EMI at great length. Most of them have been fully resolved – even though initial positions were sometimes diametrically opposed. In some cases, transitional rules were agreed for the initial phase of monetary union; they may then have to be adjusted in the light of experience gained. Legal instruments have been prepared wherever necessary. When the ECB is

established a few weeks from now, one of its first tasks will be to wind up the discussions and endorse all of this preliminary work done by the EMI.

The philosophy underlying the organization of the ESCB

How, in the light of the EMI's preparatory activities, will tasks and duties be distributed within the ESCB? What role will the national central banks play?

The basic philosophy in organizing the ESCB is to have all decisions taken centrally by the ECB; in effect, decisions on all fundamental issues will be taken by the ECB's Governing Council. This is the only way in which the uniformity of the single monetary policy can be ensured across the euro area. The implementation of decisions - that is operations, which in practice account for most of a national central bank's work - is effected by the national central banks on a decentralized basis, coordinated by the ECB Executive Board. Like a red thread, these two principles - centralized decisions and guidelines, decentralized implementation - govern all the ESCB's operations.

At this point, three concepts must be explained. The first relates to the ESCB's tasks and functions. The Maastricht Treaty provides a very clear definition of those areas which from Stage Three of EMU will fall within the Community's field of competence. Thus the basic tasks to be carried out by the ESCB are to define and implement the monetary policy of the euro area, to conduct foreign exchange operations in accordance with the exchange rate policy of the euro area, to hold and manage the official foreign reserves of the member states, and to promote the smooth operation of payment systems. In the area of the prudential supervision of banks and financial markets, the ESCB only contributes to the smooth conduct of policies pursued by the competent authorities. In addition to these basic tasks, the national central banks are free to perform other tasks, provided they are not incompatible with the objectives of the single monetary policy.

The second item requiring an explanation is the legal form of the ESCB. The ESCB has no legal personality of its own. Only its components - the ECB and the national central banks - have legal personality. The term ESCB therefore only refers to the fact that the ECB and the national central banks are integral parts of a whole that is guided by a common set of rules, objectives and duties in both its internal and external relations. This underlines the federal character of the ESCB and the institutional role of the national central banks as equal partners within the ESCB.

The third concept that needs to be explained is the principle of "subsidiarity". Under the principle of subsidiarity, the distribution of all responsibilities and tasks must allow for a maximum degree of freedom, while at the same time paying due regard to the body politic. Centralized entities should not monopolize tasks that can be performed by decentralized units. The centralized entity is to focus on the functions it has to perform in the interest of society as a whole. The European Union incorporated the principle of subsidiarity in the Maastricht Treaty:

In areas which do not fall within its exclusive competence, the Community shall take action only if and insofar as the objectives of a proposed action cannot be satisfactorily achieved by the member states. How then is the principle of subsidiarity to be applied to monetary union? The transfer of monetary policy from the national to the higher Community level is based on the conviction that this is in the general economic interest. Only the actual implementation of monetary policy may – and shall – remain the responsibility of the smaller entities, that is, the national central banks “to the extent deemed possible and appropriate”. Consequently, when we speak about subsidiarity in the context of EMU, we must distinguish carefully between monetary policy decisions and their implementation. In the former case, the principle of subsidiarity provides the motive for centralization, in the latter it is the incentive for decentralization.

Five areas of responsibility of National Central Banks

Against this background, five key areas of responsibility or functions can be identified for the national central banks. *First*, the national central bank governors will actively contribute to all central decision-making processes within the ESCB. In this context the national central banks will, *second*, serve as intermediaries between the single monetary policy and national economic policies. *Third*, they will act as the ESCB’s operative entities in carrying out monetary and foreign exchange policies as well as policies relating to payment systems and in compiling monetary and balance-of-payments statistics. *Fourth*, the national central banks will contribute the ECB’s capital and, as “the owners” of the ECB, also receive their share of ECB income. *Fifth*, the national central banks, apart from being ESCB member banks, will continue to exist as independent institutions outside the ESCB’s scope of responsibility and as such will be free to perform additional functions on their own responsibility. Let me now explore these five functions in greater detail.

1. Participation in decision-making by the ECB Governing Council

The first area of responsibility relates to the NCBs’ participation in decision-making processes. As already mentioned, the ECB Governing Council will consist of the six members of the ECB Executive Board and, for the time being, the eleven governors of NCBs. At the start, the ratio between members of the ECB Executive Board and national central bank governors will therefore be about one to two. This predominance of NCB governors in ECB decision-making will safeguard that, based on European central banking experience, the required measure of continuity is achieved in spite of the significant changes on an institutional level.

The ECB Governing Council takes monetary policy decisions by a simple majority. Each member of the ECB Governing Council has one vote. This also applies to NCB governors, regardless of whether they are from a small or a large country. This reflects the intention of the Treaty, according to which central bank governors are to serve on the ECB Governing Council as individuals, not as “country delegates” or representatives of their

institutions. They are committed to Community objectives and the tasks of the ESCB and are expected to consider the monetary policy needs of the euro area as a whole. The Treaty therefore attaches particular importance to the independence of the members of the ECB Executive Board and the national central bank governors. To ensure their personal independence, the ESCB Statute defines certain minimum requirements, including a minimum term of office and protection from early dismissal. These are additional safeguards against attempts to exert pressure by way of instructions or other influence. The prohibition to issue instructions to NCB governors applies in fact to all types of bodies, both external and internal, including the decision-making body of the respective national central bank. The Treaty deliberately refrains from providing for the disclosure of the minutes of ECB Governing Council meetings and votes cast by the individual members of the ECB Governing Council in order to assist them in acting responsibly, to the benefit of the euro area as a whole.

The call on the members of the ECB Governing Council to think “European” has also been underlined in economic theory as a necessary prerequisite for defining the best possible monetary policy for the entire euro area. Let us assume, for example, that Austria and a number of other small and medium-sized countries commanding a majority of votes on the ECB Governing Board together are enjoying a boom. Let us further assume that Germany and France, which together account for well over half of the GDP of the euro area, are passing through a period of recession. If in such a situation the central bank governors of the small countries used their majority of votes to raise interest rates in the euro area in order to dampen their overheated economies, they would be opting for a measure inconsistent with the monetary policy needs of the euro area as a whole. This example, of course, is mere conjecture, a case which is quite unlikely to develop, particularly as we may expect the business cycles of the euro area countries to continue to converge as they have for the past few years. The example nevertheless serves to illustrate the principle that monetary policy decisions of the ESCB must always be to the benefit of the euro area as a whole and must not cater to national interests.

This also shows very clearly how important it is for each national central bank to have its own macro-economic analyses available for the meetings of the ECB Governing Council. The staff of the ECB Executive Board in Frankfurt will certainly draw up a full set of data and analyses, which will be available to all members of the Governing Council. NCB governors will, however, be well advised to have their own analyses of developments in the euro area and the global economy, prepared by their in-house staff of economists and statistical experts, possibly dealing in greater detail with issues of particular interest from a governor’s own perspective. The example of the Federal Reserve System in the United States shows that well-prepared information is an indispensable decision aid for the participants of meetings at which monetary policy decisions have to be taken. The sounder and more compelling the arguments that a central bank governor presents to the ECB Governing Council, the greater his or her chance to convince the other members.

The experience of the Federal Reserve System also demonstrates that national – regional, in the US – central banks can find their own market niches in research and analysis. For the OeNB, for example, I would see a comparative advantage in studies on the transition countries.

2. Public relations agent and interface between the single monetary policy and national economic policies

A second important role of national central banks resulting from the first one is to act as public relations agents and interfaces between the single monetary policy on the one hand and the public and economic policy-makers on the other hand. The ESCB's – as indeed any central bank's – successful implementation of the single monetary policy will depend substantially on its ability to communicate effectively with the general public and economic policy-makers.

Like any central bank today, the ESCB will have to keep citizens informed about its strategy and the motives behind any action it takes. This is the only way to ensure that the European public will understand, endorse and support its monetary policy. For a number of reasons, the national central banks will have a central role to play in this context. They are the ones best acquainted with their countries' weak spots and special concerns. They speak the language of the people in the countries they represent – both literally and metaphorically. They have enjoyed the population's confidence for many years. They have a close network of formal and informal communication channels. And they have the resources required for public relations work that will reach the general public, a task which may prove time-consuming and make huge demands on an NCB's manpower resources. The national central banks are therefore ideally placed for conducting the ESCB's public relations activities in the participating countries. Care will have to be taken, however, to ensure that such decentralized public relations efforts will still follow a clear common line.

A second central aspect of the NCBs' intermediary function is their role as a communication channel to national economic policy-makers. It is in the nature of EMU that one single monetary and exchange rate policy will apply to the entire euro area. Different national monetary policy stances to balance differences in economic developments and structures are no longer possible. The balance must therefore be achieved by means of other economic policy instruments, i.e. the national fiscal, income and structural policies.

These areas of economic policy are of course beyond the central banks' immediate scope of competence. It is, however, part of the central banks' responsibility to alert economic policy-makers at the national level as well as the public to any adjustments that may be necessary. This is the only way to make sure that the euro area member states will be able to reap full benefit from EMU and to minimize potential disadvantages. Here, it will be of central importance that budgetary policies are closely coordinated at the national level, that government

budgets are put on a sound footing in accordance with the provisions of the Growth and Stability Pact and more flexibility is aimed at in economic structures.

Ideally, EMU will be an incentive for EU governments to tackle pending economic reforms more swiftly and with more determination. Thus, EMU could act as a catalyst in European economic development. The significant reform efforts undertaken in the past months and years in all of the EU member states in the run-up to EMU make me confident that this positive scenario is attainable. In fact, to some extent EMU has already had highly beneficial impacts on economic policy in recent years, although it has not even started yet. We must be aware, however, that the reforms that have been initiated must now be continued and that participation in EMU requires an increased readiness for permanent change and reform.

As it has been possible during the last year to convince the Austrian population of the benefits of the euro, I trust that it will be equally possible to motivate the citizens of Europe to take up the structural reforms that will have to accompany the euro if its full rewards are to be reaped. Here the NCBs will have to play an important role as mediators, coordinators and public relations agents in issues dictated by a single monetary policy within the entire euro area and the economic policies of the member states. Drawing on their economic expertise, the national central banks will be able to provide valuable assistance to economic policy-makers at the national level in formulating arguments for the reforms needed. Being independent institutions, however, they should also stand ready to act as the voice of reason and alert economic policy-makers in due time if necessary.

3. The National Central Banks as operative entities of the ESCB

Let me now move on to the third key function of the national central banks. The NCBs will be the operative entities of the ESCB. Preparatory work by the EMI has shown that decentralization of a very large portion of the central banks' operative activities is both "possible" and "appropriate". Using advanced information technology, money market tender operations, for example, can be conducted on a decentralized basis at reasonable expense.

At the same time, the benefits of a decentralized approach are quite obvious. It will permit the use of the NCBs' infrastructure and the benefit of their experience in conducting monetary policy and other operations. Watching their national financial markets evolve, the national central banks have accumulated a wealth of experience over the decades. At the early stage of monetary union, these markets will still differ substantially. In order to guarantee nevertheless equal and fair access to central bank liquidity for the large number of the ESCB's counterparties, the national central banks will assume an indispensable function as intermediaries between the ECB's monetary policy decisions and the counterparties of the ESCB. The national central banks will also be best placed to monitor, on a continuous basis, the rapid and substantial changes in the conduct of market players triggered by monetary union itself. This will ensure that the ESCB's monetary policy instruments retain their effectiveness and efficiency even in a

rapidly changing environment.

The national central banks will therefore conduct open market transactions and other monetary policy operations with the banks in accordance with instructions issued by the ECB. Upon decision of the ECB, they will intervene on the foreign exchange markets. They will print and issue banknotes. The commercial banks will maintain their minimum reserves with the national central banks if such reserves are going to be an instrument of monetary policy – which I would indeed advocate. The national central banks will supervise payment transactions, acting as system operators in large-volume payments. They will collect statistical data, and they will continue to cooperate in monetary policy-making on an international level, as in the IMF and the BIS.

Let me mention just two examples to illustrate the national central banks' important function in operative business: First, let us consider their role in monetary policy operations within the ESCB. As a rule, decisions with regard to instruments used to allocate or withdraw liquidity on the initiative of the ESCB will be taken centrally by the ECB. However, their implementation and administration - carried out in line with the ECB's instructions - will largely be the responsibility of the national central banks. Open market operations will for the most part remain the exclusive task of the national central banks. These include regular weekly tender operations with a term of two weeks, regular monthly longer-term refinancing operations with a term of three months, structural open-market operations and, possibly, the issuance of central bank debt certificates. Only fine-tuning operations, outright transactions, foreign exchange swaps and the acceptance of time deposits may in exceptional cases be executed directly by the ECB upon decision of the ECB's Governing Council. As regards standing facilities, i.e., the marginal lending facility and the deposit facility, banks will be dealing only with the NCBs. Minimum reserves will also be held exclusively by the national central banks.

The second example relates to the administration of foreign reserves. The ECB will be provided with foreign reserve assets for possible interventions in the exchange markets and to support confidence in the euro. Initially, these foreign reserve assets will amount to a total equivalent to up to EUR 50 billion (about ATS 700 billion). In the starting phase, the OeNB will therefore transfer up to about ATS 16 billion of its foreign reserves to the ECB. The national central banks will continue to manage the transferred foreign reserves on behalf of the ECB on a fiduciary basis, in compliance with the ECB's investment rules. The predominant part of Austria's foreign currency reserves will be retained and invested by the OeNB. Transactions by national central banks involving such foreign currency reserves will be governed by guidelines in order to prevent any possible undesirable impact on the monetary and foreign exchange policies of the euro area. Very large foreign currency reserve transactions will even require the approval of the ECB.

As these two examples clearly illustrate, the operative framework of the ESCB as prepared by the EMI heavily relied on the national central banks' existing resources and merely confers the decision-making powers on the ECB.

4. Holders of the capital of the ECB

What kind of role will the national central banks be playing as the "holders of the capital" of the ECB? The ECB will have a subscribed capital of EUR 5 billion (about ATS 70 billion). The national central banks will be the sole subscribers to and holders of the capital of the ECB. Only the NCBs participating in the euro area member states will pay up their share in the capital. The capital subscription of the national central banks is based on a weighting of 50% for the share of the respective Member State in the population of the Community and 50% for the share of the respective Member State in the GDP of the Community. The OeNB's share will amount to about 2.3% or some EUR 115 million (approx. ATS 1.6 billion). Based on eleven countries participating in monetary union from the start, the OeNB's share in the *subscribed* capital will be 2.9%.

Capital subscription entitles the OeNB to a proportionate share in the ECB's profit. The key for determining the share of capital to be paid up will also be instrumental in determining the distribution of monetary income earned by the national central banks from the issuance of central bank money. Under the ESCB's Statute, the monetary income of all participating national central banks will be paid into a common pool and then redistributed in accordance with the key for capital subscription. This procedure was chosen because it is impossible to predict the regional distribution of central bank money creation within the monetary union. Incidentally, this is not a problem, as the entire euro area will be a single currency area with identical money market rates and uniformly applicable terms governing the allocation of central bank money. However, to ensure an equitable distribution of income from the creation of money within the ESCB, a profit distribution mechanism will be installed. At least in the early phase of monetary union, however, there will still be substantial differences in the central banks' balance sheets owing to national differences in the use of cash, payments and savings habits. Consequently, transitional arrangements have to be made for the initial period before the monetary income distribution mechanism can be introduced. Once the structures of national financial markets and the circulation of banknotes and coins begin to converge, it will become easier to define an appropriate approach to the gradual introduction of the monetary income distribution mechanism.

5. Other activities remaining within the NCBs' responsibility

Let me now come to the last area of central bank activities. Beside their function as an "integral part of the ESCB" the national central banks frequently perform a number of specific duties they have grown into in the course of their history. Such public duties above all

include tasks relating to the supervision of banks and financial markets, carried out either directly in their function as a supervisory authority or as an expert pool supporting the authorities charged with banking supervision. Some central banks prepare analyses of the financial statements of companies established in their countries in connection with their use of instruments of monetary policy and as a service to the business community. Sometimes, central banks are involved in the government programs for the promotion of exports and research. Beyond that, central banks frequently provide financial services to public entities. Some central banks manage accounts for private-sector customers, much like commercial banks. Other central banks hold interests in production or service industries, which may be for commercial or strategic reasons.

The Statute of the ESCB does not envisage any forceful dismantling or unification of the structures that each national central bank has developed in the course of time. They are therefore free to choose their own legal form and organization. However, it must be clearly pointed out that any national central bank will perform such additional tasks within its own responsibility and for its own account and that such tasks are not deemed to be part of ESCB activities. Furthermore, the ECB Governing Council may decide by a two-thirds majority that certain activities fail to comply with the contractual and statutory tasks and duties of the ESCB and may decree their discontinuation. Previous work by the EMI on this issue, particularly studies on legal convergence, indicate that restrictions will be imposed only if such an activity threatens to impair the single monetary policy.

Restructuring of the OeNB in the Run-Up to Monetary Union

...The fundamental reorganization of central banking in Europe associated with monetary union has also required restructuring of the OeNB, involving several levels:

The first of these levels relates to the transformation from a central bank in its own right to an integral part of the ESCB. The goal and strategy of monetary policy, its intermediate target as well as the monetary policy instruments must be harmonized with those of the ESCB. The OeNB initiated this development already several years ago in order to ensure as smooth a transition as possible for Austria's financial system. After decades of stability-oriented policies, the transition to the monetary policy goal laid down in the Maastricht Treaty actually involved no change for us. The move from an intermediate exchange rate target to a new strategy was preceded in the OeNB by preparatory studies and the development of the required know-how through research work. Moreover, in recent years the OeNB gradually transformed its monetary policy instruments into market-oriented instruments. The remaining adjustments to be made in cooperation with the banks are already far advanced.

A second aspect is the review of the OeNB's areas of operation. The OeNB will in essence continue its activities in all of its previous areas of responsibility also after Austria's entry into Stage Three of monetary union. In many fields, however, the focus will change more or less markedly. The OeNB's macroeconomic analyses, for example, will cover monetary policy

in the entire euro area in order to provide the best possible briefing to the OeNB Governor ahead of the regular conferences of the ECB's Governing Council. On the other hand, the impact of a single monetary policy on the Austrian economy will have to be identified and recommendations worked out for domestic economic policies. Furthermore, the economic development of our neighboring countries in the east will remain of key interest to the OeNB's analytical work. I already mentioned the changes in the operative aspects of monetary policy. The OeNB will continue these activities within the ESCB. The OeNB will also continue to collect monetary and balance-of-payments statistics in Austria, albeit in a form that has been harmonized for the entire euro area. In the area of payment systems, monetary union has provided a fresh impetus to the OeNB. The OeNB has developed and successfully implemented ARTIS (Austrian Real-Time Interbank Settlement), a new payment system meeting European requirements and ready for integration into TARGET, the European payment system, from Jan. 1, 1999. The OeNB has also made intensive and thorough preparations for the production and distribution of the future euro banknotes. The design contest for the future euro banknotes was won by a graphic artist employed with the OeNB. By setting up a new printing works for banknotes, the OeNB has the required technology in place for the production of euro banknotes. In the field of banking supervision, the current responsibilities of the OeNB are in no way affected by the establishment of the ESCB. Monetary union will, however, intensify and speed up restructuring processes in the European financial markets. More market transparency, increased cross-border competition, progressive disintermediation and rising financial exposure against a background of much more closely knit world financial markets will pose formidable challenges to the bodies responsible for supervising financial markets and banks. The OeNB responds to this situation with a staff of qualified employees and active participation in the ever tighter international coordination of supervisory authorities.

On a third level, the reorganization involves legal and organizational restructuring of the OeNB. The Austrian central bank has a long tradition as an independent institution. The requirement under the Treaty of Maastricht to harmonize the central bank statutes with the provisions of the Treaty by the time the ESCB is established therefore implied no major change in the OeNB's role as a central bank. Nevertheless, two areas required adjustments, spelled out in a recently adopted amendment to the Oesterreichische Nationalbank Act. On the one hand, the institutional framework ensuring the independence of the OeNB decision-making bodies had to be defined in greater detail. The distribution of powers between the OeNB General Council and the Board of Executive Directors was adapted and the functions of Governor and Vice-Governor newly introduced. Furthermore, the article in the Nationalbank Act which defines the OeNB's tasks and objectives was revised to comply with the formulation of objectives as laid down in the Maastricht Treaty. Secondly, the provisions regulating duties and instruments were revised to ensure the OeNB's integration into the ESCB.

Outlook – the road to monetary union as an evolutionary process

...The establishment of EMU and the ESCB is an evolutionary process. During the past few years all of the EU member states have undergone a remarkable process of economic convergence, which has not been confined to compliance with the convergence criteria alone. More specifically, we have seen a clear approximation of economic policy goals and the measures considered appropriate for achieving these goals. There is no doubt among the governments of EU member states today about the necessity of a stable monetary environment and sound government budgets as a basis for sustainable growth. Continuation and intensification of the convergence process in the national economies and economic policies over the next few years will be critical to the success of EMU. There must be further pressure for structural reforms designed to make the economy more flexible. Fiscal policy must aim at a conscientious implementation of the Stability and Growth Pact. Government budgets must be balanced to recover leeway for fiscal policy that has largely been lost in recent years. These changes do not meet us unprepared. They merely continue reforms initiated in the past and present steps that would have been necessary in any case, even without EMU.

The beginning of monetary union marks a change in paradigms governing the interaction of the institutions that shape economic policies in Europe. The change has an impact on the relations between central banks and other economic policy-makers at both the Community and the national levels. The role played by the national central banks will also change dramatically within the ESCB. However, the change will not come as an unexpected shock, but rather as the result of many years of preparatory activities. All of the institutions involved have taken part in these preparations, contributing their know-how and experience. Those responsible for economic and monetary policies in the national finance ministries and central banks as well as in the Commission and in the EMI will largely be serving in similar positions within EMU, thereby ensuring continuity.

The degree of mutual convergence already achieved is particularly apparent in monetary policy and central banking. Coordination of monetary and exchange rate policies within the EMS over the past twenty years and preparations for monetary union since the early 1990s have resulted in an impressive convergence in the perception of the role and tasks of monetary policy and of the overruling target of price stability. This was also highlighted very clearly in the convergence reports of the EMI and the Commission. The financial markets have rewarded these efforts by a convergence of interest rates and stable exchange rates. Today, all of the EU central banks participating in the euro area from January 1, 1999, are independent, committed to the primary target of price stability and have already largely adapted their monetary policy instruments to the future needs of the ESCB. The ECB will bring together what is best in the traditions of the European central banks. The same central bank governors who are responsible today for their countries' stability-oriented monetary policies will be shaping the monetary policy for the euro in their function as members of the ECB Governing Council. All these arguments give me the confidence that the ECB will be able to enjoy, from the very

beginning, the same credibility that the most successful central banks of the ESCB have had in the past.

The principle of evolution will also – and very much so – apply to the future distribution of duties within the ESCB and thus to the national central banks' role within the System. The histories of the few existing central bank systems organized on federal principles show that the assignment of tasks and duties within such a system may undergo substantial changes over the years in the light of practical experience. Let us take a final look at the US Federal Reserve System. When this system was first established, it was extremely decentralized. As new experience was gained, decision-making on monetary policies as well as the operative branch of monetary policy were centralized. By this I certainly do not wish to imply that the operative activities of the ESCB will be moving towards centralization. The Fed and the ESCB are developing against vastly different historical and political backgrounds. The European Monetary Union is a union of independent states, whereas the Fed System operates in a unified nation. Accordingly, unlike the countries within EMU, not every US state has its own Federal Reserve Bank. Communications and information technology are, moreover, infinitely more advanced today so that the decentralized management of the ESCB's operative activities will be much easier to organize than it was in the Federal Reserve System at the beginning of this century. The history of the Fed would, however, suggest that the organization of the ESCB, too, may be subject to an evolutionary process in the course of time, and that the exact direction of this evolution will be influenced by experience gained in the conduct of monetary policy.

Much will also depend on the direction in which the European Union will be moving as a whole. To the extent to which integration advances, to which national borders become more and more insignificant and to which political union increasingly takes shape, a parallel development might take place within the ESCB. Political and general economic integration of the Community and experience with a single monetary policy will – as I hope and expect – influence each other in a mutually beneficial process.