

The euro: a new currency for Europe

Dinner speech delivered by

W. F. Duisenberg, President of the European Central Bank

at the Bank of Thailand on 19 December 2000

Ladies and gentlemen, distinguished guests. May I first say that it is an honour to be invited to say a few words to you this evening about Europe's new single currency, the euro. I have to admit that one would not normally think of a currency as being a particularly likely or interesting subject for a dinner speech.

For the euro, however, I think I am correct in saying that this is not the case. Indeed, the euro is a currency quite unlike any other. It is not a national currency. Instead it is a supra-national currency created by a monetary union of 11, soon to be 12, sovereign member states creating the second largest monetary area in the world. It is also a very new currency, still less than two years old. It does not yet circulate in the form of banknotes and coins. Not surprisingly, therefore, the euro does indeed attract a great deal of public attention.

It is notable, however, that different observers seem to perceive the euro in very different ways. Some focus their attention almost exclusively on the exchange rate, overlooking the fact that the ECB's principal aim is to maintain price stability and not a fixed exchange rate. Others seem to consider the euro purely in terms of a political or economic experiment. They fail to notice that it is already a fully functioning single currency.

This only serves to convince me that, even two years after its introduction, there is still a need for the euro to be explained to the public at large. And, this is perhaps all the more so outside Europe where understanding of European integration and policy-making is, not surprisingly, more limited. Therefore, I very much welcome this opportunity to say a few quite general words to you about what the euro is, how it works, and what it means, both for the euro area and for the world at large.

* * *

Let me first say that one should never try to understand Europe's new currency in isolation or as a currency which was merely introduced on 1 January 1999. In fact, the euro is just one, albeit an important, part of the process of creating an economic as well as a monetary union in Europe. This process began already a decade ago. Similarly, this "Economic and Monetary Union" is itself part of a much broader process of European economic and political integration. Therefore, in order truly to understand the euro one should in fact consider it first in the context of the European integration process that began already five decades ago.

From the beginning, the purpose of this process was to bring the countries of Europe and their economies closer together and, in so doing, create an area of peace, prosperity and stability. I suppose these motivations are by no means dissimilar to those which lie behind the various other regional links which have since been formed in other parts of the world, including here in Asia.

The European experience in working towards this goal has been one of gradual progress, even though with numerous ups and downs. Nonetheless, the main objective remained ever intact. As economic integration progressed further and further, as we overcame ever more subtle barriers to trade, it became increasingly apparent that one substantial barrier to the creation of a truly pan-European economy remained. I refer of course to the persistence of exchange rate fluctuations which resulted from the existence of separate national currencies governed by independent monetary policies.

In short, European policy-makers had to face up to the fact that, over extended periods of time, you cannot simultaneously maintain free trade, unrestricted capital movements, fixed exchange rates and independent monetary policies. A choice had to be made and ultimately the time arrived when most European countries deemed it more advantageous to firm up the European "Single Market" than to maintain their national currencies.

* * *

I should add that, beyond this more fundamental motivation, there were other important developments which probably influenced the decision to adopt a common currency. The end of the Cold War set new political parameters for the integration of western Europe. Regional integration and the creation of a large economic area have also come to be seen as even more necessary in order to prosper in an increasingly globalised world economy.

From the point of view of a central banker, the evolving consensus as to the appropriate role of monetary policy and of a central bank was particularly important in laying the foundation for a viable single currency. Moreover, an increasing awareness that using monetary policy directly to stimulate growth and employment was not working and was even proving counterproductive, might have strengthened the perception that, in an already deeply integrated Europe, there was little to lose from giving up autonomous monetary policies. By contrast, a good deal could be gained by removing exchange rate fluctuations and by establishing an independent European Central Bank with a clear objective to maintain price stability.

* * *

But the evolving consensus to which I refer did not just apply to the field of monetary policy. Nor would it be correct to say that consensus on the objective of monetary policy is sufficient for the creation of a successful monetary union. The euro becoming a reality also depended on the consensus which evolved on the need for sound economic policies more generally. This made it possible for all of the countries which have now adopted the euro to develop and agree on the overall economic framework needed to complement and support a monetary union.

Like the process of European integration itself, a framework for co-ordinating economic policies has developed gradually and over a considerable period of time. The result is a flexible framework in which national policies are appropriately co-ordinated rather than centralised. And this is indeed quite appropriate. In a monetary union it is even more necessary than before for economic policies to take national differences into account.

On the other hand, we do see a need to ensure that national policies take into account the shared responsibility of participation in the single currency. This is why, in the area of fiscal policy, co-ordination does take quite a strong form with national policies being subject to binding rules. In this context, governments have committed themselves to what is called the Pact for Stability and Growth in order to reduce government deficits to close to balance or even to create surpluses in their budgets. And indeed over the past years, government finance positions in Europe have improved remarkably. In other policy areas, however, the countries of the euro area continue to co-ordinate their policies in more subtle ways. They exchange ideas and information; they agree general guidelines and recommendations; and they regularly monitor and share assessments of

each other's policies. In this way, economic co-ordination, in all its various forms, promotes and, where necessary, ensures that national policies are appropriate and consistent with participation in the single currency. In strictly legal terms the euro may be a "currency without a state". In practice, like any other currency, it is embedded in a well-developed and comprehensive economic policy framework.

Of course, the one area of policy which is now completely centralised is monetary policy. The countries which have adopted the euro now share a common currency, a single exchange rate and a single monetary policy. The responsibility for conducting this policy has been given to the ECB/Eurosystem, with a clear mandate to maintain price stability. Like the Federal Reserve System in the United States, Europe's central bank is organised as a federal system. In the centre is the ECB, based in Frankfurt am Main, Germany. The national central banks (NCBs) of the countries which have adopted the euro are also part of what we call the Eurosystem. Monetary policy decisions are made by the Governing Council of the ECB. This Council comprises the six members of the ECB's Executive Board and the Governors or Presidents of the NCBs of the countries which have adopted the euro. Decisions are made on a one person/one vote basis. This reflects the fact that they always have to be made in the interest of the euro area as a whole. Therefore, members of the Governing Council do not represent their country or even their NCB. They have been appointed in a personal capacity. Their mandate is to maintain price stability in the euro area as a whole. The Eurosystem is an independent entity. This is enshrined in the Treaty establishing the European Community, which has been ratified by all the 15 Member States of the European Union.

And let me just say that I am quite proud of our achievements so far. The ECB's monetary policy and its strategy have worked well, in spite of the initial uncertainties associated with the changeover to the single currency. Price stability is being maintained, even if recent price increases have temporarily exceeded our target, mainly as a result of the almost tripling of oil prices. Moreover, the markets seem to have confidence in the ECB and its policies, as is shown by the level of long-term interest rates. In the euro area, these have remained persistently at or below US levels.

* * *

But let me move on, since the euro also has implications extending well beyond the euro area which I should also briefly touch upon. As I mentioned earlier, the euro is the currency of the world's second largest monetary area. The euro/dollar foreign exchange market is the largest in the world and around 40% of international debt securities issued over the past two years have been in euro. The euro is already an international currency, second only to the US dollar, and businesses and investors around the world need to take this into account.

In this regard, however, let me just say that some of the speculation about the international role of the euro, and especially the suggestion made by some that the euro would soon rival the dollar, has not been particularly helpful. I prefer to refrain from making such predictions. Rather, I believe that the attractiveness of a currency depends crucially on the underlying policies for economic growth in the country, or countries, concerned.

What I can say with confidence, is that the euro is playing and will continue to play a role in offering new and good investment opportunities, including for investors based outside the euro area. In this regard, the euro is already acting as a catalyst for the development of a fully integrated European capital market. This market will be more efficient and more liquid than the segmented, national markets which preceded it. Ultimately, however, and I repeat, the extent to which this translates into actual inward investment will depend on the market's perception of economic policies and growth potential in the euro area.

And this brings me to another important role of the euro, namely, it acts as a catalyst for economic reform. Among other things, the adoption of a single currency means that euro area governments no longer have national currencies which they can devalue in times of need to protect inefficient industries. Instead, other ways have to be found to maintain competitiveness, both within the euro area and internationally. I believe it is no coincidence that policy-makers across Europe are now focusing more than ever before on how to overcome the economic rigidities which, in recent years, have tended to hold Europe back in terms of economic growth. Indeed, I would not even be that surprised if, looking back some years from now, it is as a catalyst for reform that the euro will be deemed to have had its most profound effect.

I should also add that a lot of progress has already been made. In addition to low inflation, economic growth in the euro area is higher than it has been for a decade and unemployment is on

a clear downward trend. Budgets have been consolidated and structural reforms are under way. If this development continues, I am confident that the euro has a very promising future.

* * *

In the meantime, however, another "euro changeover" will occur. One which, for ordinary euro area citizens, will not only have a profound but also an immediate and clearly perceptible impact on their daily lives. I refer to the introduction, in a year's time from now, of euro banknotes and coins.

As any of you who have travelled to the euro area recently will have noticed, even though our currency is now officially the euro, we are still continuing to use our national banknotes and coins for the time being. In just over a year, however, all this will change. You will then be able to travel some 3,000 kilometres or so from Lapland in the north of Finland to Andalucia in the south of Spain without needing to visit a single bureau de change. No doubt, this is one implication of the single currency that at least the more mobile citizens of the euro area, myself included, as well as visitors from abroad, will very much appreciate.