

Nadège

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« The euro at fifteen months »

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Ladies and gentlemen, it is a great pleasure and an honour for me to be speaking here, in Paris, in front of such a distinguished audience. I am particularly happy to express my views on the successful introduction of the euro, and the necessary conditions for its durable success. But, first, within the context of this conference on the euro capital markets, let me recall recent announcements regarding mergers or close cooperation between stock exchanges, securities settlement systems, clearing houses, and so forth. It is obvious that the setting up of the Euro is fostering large scale restructuring of markets throughout Europe. The Euro is a strong catalyst for structural reforms in Europe.

On the 1st of January 1999, a unique event in the history of Europe occurred. The euro was born and the irreversible nature of this change has convinced an increasing number of political and economic actors that the success of the euro is a necessity

for Europe. It is a keystone of the European single market which will ensure prosperity in Europe for the benefit of the rest of the world.

It is clear that, now and for the future, we have to face a number of challenges to make this success sustainable. I would like today to draw your attention particularly to the following two issues :

- First, the euro area members have to meet certain conditions for the euro to be a full success;
- Second, the euro will make an important contribution towards encouraging a balanced international monetary situation.

**I/ THE SUCCESS OF THE EURO WILL BE COMPLETE
IF A NUMBER OF CHALLENGES ARE TAKEN UP**

The successful introduction of the euro is, in itself, a major reform. But it will be fruitful only if some conditions are met, above and beyond monetary policy, in particular regarding structural reforms.

A few years ago, it was necessary to convince a great number of sceptical people, in Europe as well as in the rest of the world, that the euro was a viable project. Many people pointed to its presumed contradictions, and its alleged inconsistencies: for example, the impossibility of achieving an efficient policy mix without a political federation; the impossibility of avoiding some "asymmetric shocks" (that is to say difficulties occurring in a Member economy and not in others); the lack of sufficient flexibility of the economy and real mobility of the labour force in the European countries etc... The conclusion was that the euro would never exist !

Facts have refuted these criticisms. But these criticisms are useful to help answering the question of what are the conditions for ensuring that the euro is a complete success. I see four conditions:

-The first condition is the credibility of monetary policy guaranteed by the independence of the European Central Bank, which is enshrined in the Maastricht Treaty and rooted in the independence of each national central bank. If the euro is to be a credible currency, it must win the confidence of the 292,6 million Europeans in the euro area and also the confidence of other Europeans and non-Europeans with whom we do business.

The necessary dialogue between monetary policy officials and economic policy officials must take into account the independence of the Eurosystem— the grouping of the ECB and the eleven national central banks- and also the objective of

price stability which, according to the Treaty, must guide the monetary policy of the euro area. Respect for the independence of the Eurosystem is a condition for the success of the euro and for the success of the European economic policy.

As a matter of fact, the harmonious functioning of the European monetary team, composed of the ECB and the national central banks from the eleven founding euro area countries, will facilitate the compliance with this first condition related to the credibility and the independence of the monetary policy. This is this full, eleven-member monetary team with the ECB acting as a coach, the Eurosystem, which is playing on the field, with a single team spirit ; and this team spirit is one of the priceless assets of Europe.

-**The second condition** is compliance with the provisions of the Treaty and the guidelines laid down in the Stability and Growth Pact with regard to fiscal policy. Close coordination of fiscal

policies and vigilant peer surveillance are the responsibility of the informal council of the eleven participating Member states - the "Euro Eleven"- and of the ministers of finance of the 15 Member states convened in the Ecofin Council. Coordination and surveillance are essential for the success of a balanced policy mix throughout the eurozone. Adherence to the medium-term objective of achieving " public finances that are close to balance or in surplus" -meaning nobody gets to run a selfish budget deficit - is indispensable for the union as a whole to weather periods of economic difficulty and for individual countries to withstand possible economic downturns which affect only their own economy.

We have to understand that monetary policy alone cannot ensure price stability without the appropriate fiscal discipline at the overall level of the Economic and Monetary Union.

Indeed, for my part, I would give **three economic justifications** for the Treaty provisions that gave rise to the Stability and Growth Pact:

- First, by coordinating the fiscal policies of the Member States of Monetary Union, the pact ensures a good policy mix within the euro area. This is essential for monetary policy. Since Europe does not have a significant federal budget, just as it has no federal government, the sum of the national budgets must serve as an overall budget for the area as a whole. This calls for close mutual surveillance and coordination of fiscal policies within the area. We have to understand that monetary policy alone cannot ensure price stability without the appropriate fiscal discipline at the overall level of the Economic and Monetary Union.

- Then, the pact helps prevent well-managed economies from having to bear unjustified risk premia by setting up a system of penalties for excessive deficits.
- Finally, the stability pact allows us to disprove the assertion that the euro area has no automatic stabilizers in the event of asymmetric shocks to a member economy. Indeed, by urging governments to aim for a fiscal position of «close to balance or in surplus» in the medium term, the pact enables them to let fiscal deficits increase during recessions without exceeding the 3% reference value. In short, it allows them to create a fiscal buffer during normal economic periods that can be drawn on, if an asymmetric shock occurs.

-The third condition, for a complete success, is that all European countries must resolutely undertake structural reforms. Continental Europe is experiencing too high levels of unemployment, despite the fact that the jobless rate has been

declining in most of its economies. According to the IMF and the OECD, around 80% of this unemployment is structural, that is, generated by our own burdensome rules and regulations. The Monetary Policy Council of the Banque de France and the Council of Governors of the European Central Bank are in full agreement with this analysis.

Just recently, some external observers were still reproaching Europe to focus its efforts and political energy on the euro, instead of implementing the structural reforms necessary for more dynamic job creation.

These critics were wrong regarding the untimeliness of the euro, but their assessment of the problems of the European economy is obviously correct. The euro will complement and foster, rather than detract from, structural reforms. Most importantly, a single currency will ease the flow of goods, services and capital within the eurozone. And the euro will also

encourage "cross fertilization" of best practices through stronger coordination of member states structural policies in areas such as labour markets, education and training, job creation incentives, effective welfare safety nets, etc..It is the reason why the december 1997 European Council meeting in Luxemburg has decided to take this necessity into account and has explicitly mentioned structural policies among the items selected for reinforced coordination.

The Lisbon European Council, held last march 23th, is a further important step towards the necessary medium term strategy for structural reform in the Union.

-The fourth condition is that all economic leaders in Europe must be clear-sighted with regard to the crucial question of competitiveness. Pre-euro economic policy meant monitoring trade balances, the balance of payments and the foreign exchange and interest-rate markets. Authorities thus received constant feedback on key indicators affecting national economic

performance and could react accordingly. These indicators were sensible, multiple and very reactive.

Most of these indicators have disappeared at the national level or have seen their significance weakened, with the advent of the euro. But, of course, they remain on the euro-wide level. This is also why the coordination of fiscal and economic policy provided for by the Treaty is so important.

Nevertheless, the rules of a market economy, especially competition, continue to apply to each economy. Jobs are created by consumers when they choose the goods and services they feel are the best value for money. Businessmen allocate these jobs to various possible locations in various countries according to the relative competitiveness of these locations. It is therefore necessary to monitor competitiveness

even more closely than before through indicators such as unit production costs, and the tax and regulatory framework.

Contrary to the pre-euro period, loss of competitiveness will not show up so quickly on radar screens like exchange markets, interest rates markets or external accounts. So, economic managers must be even more vigilant in watching pertinent competitiveness indicators. The sanctions for economic policy errors might come more slowly and insidiously via rising unemployment and weak growth.

**II/ THE SUCCESS OF THE EURO WILL YIELD A
CONTRIBUTION TO AN APPROPRIATE ECONOMIC AND
MONETARY EQUILIBRIUM IN THE WORLD.**

In the current overall economic situation, the success of the euro will help both Europe and the rest of the world. Indeed, our partners, notably the United States or the European countries which are candidates to enter the European union, are interested in and associated to European prosperity and growth as part of a healthy world economy.

Clearly, the new monetary setting in Europe has, and will have, far-reaching consequences not only for Europe as a whole and its people, but also for the world economy and the international community.

The euro area contribution to international stability may be appreciated through the development of balanced economic relationships between the euro area and the rest of the European Union, and with the countries outside the European Union, in particular through the reinforcement of international financial and monetary stability.

The relationship between the monetary union and the other countries of the European union will be based on coordination.

Coordination of the economic policies of the 15 countries of the European Community is required by the Treaty. It is necessary for the European Union to function properly at the economic level. It is important that the dialogue between all EU countries continues, even though the changeover to the euro modifies the traditional economic environment of the European Union.

In particular, the coordination between the 15 countries will allow the countries that have not yet joined monetary union to converge towards the euro area. The new exchange-rate mechanism (ERM2) that links, to the euro, some of the currencies concerned (this is the case of the Greek drachma and the Danish krone since January 1st 1999) will play its part

in this process. By promoting exchange-rate stability, the new ERM will ensure that the single market operates smoothly and will help the "out" countries to qualify for the single currency.

The Monetary Union will also have close relationships with countries outside the European Union.

First, the monetary union and the European Union will be an attractive pole for the accession countries. The results achieved by some of them during the last years show remarkable improvements. They must keep on making an effort to be able to join the EU and, then, in due course, EMU in fitting conditions, which is in their own interest and in the interest of current EU member states.

Second, with regard to international cooperation, the euro area will also play an important role. It represents an area of stability and sustainable economic growth for some 292,6 million

inhabitants, and it will definitely have a substantial influence in the international community. The euro will make the international economic cooperation process easier between the main partners - the United States, Japan, and the Euro area. Each of them is in a position to speak on behalf of a large economic area. Moreover, each partner is vulnerable to a rather similar degree to adverse shocks occurring in the international financial system. Therefore, the euro should foster a balanced relationship in which each partner will take on responsibility for contributing to a stable global environment.

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In conclusion, let me stress three points :

Firstly, the strategy that is best for the Eurosystem can be summed up in two key words: confidence and vigilance. It was this confidence and this vigilance that lay behind our decision of

16 March last, when the ECB Governing Council raised the Eurosystem's tender rate from 3,25% to 3,5%.

Our decision was made in order to maintain price stability over the medium term. Economic conditions and prospects for the euro area appear to be better at present than at any time in the past decade. At the same time, upside risks to price stability were seen as a reason for vigilance. The decision taken by the Governing Council addresses those upside risks, thereby strengthening the conditions for a growth path which is as sustainable as possible by virtue of being non-inflationary.

In taking this decision, we wanted to send out a **three-fold signal of confidence**:

- a signal to all economic agents of our confidence in the reality of the robust growth of the European economy today.

– a signal to businesses of our determination to ensure that this growth lasts as long as possible.

–**And finally**, a signal to savers of our commitment to the stability and the credibility of the single European currency over the medium term.

Indeed, observers did understand the nature of this three-fold signal. In the occasion of our most recent meeting in Madrid, we agreed that the Governing Council shall continue to be vigilant in order to be in a position, if needed, to counter inflationnary pressure in a timely fashion.

As regards the euro and its exchange rate I will remind that we have a unanimous position in the Governing Council of the European Central Bank : the present level of the euro does not reflect the significant recent improvement in the outlook for the euro area economy.

Secondly, as regards the recent evolution of stock markets, I will recall that central banks have a special responsibility as regards not only monetary stability but also financial stability.

In this perspective, I will stick to three short comments :

–First, we have witnessed a great deal of market volatility and excessive volatility is never desirable.

–Second, we call for investors to assess the merits, chances and risks of their investments after thorough analysis of the particular entity concerned and not on the basis of an irrational herd behaviour. Full transparency of the market and rational individual decisions are not only theoretically desirable but are preconditions for avoiding as much as possible the successive and contradictory waves of fashion.

–Third, I suspect that the generalisation of « Indices based management » strategies should be monitored very carefully, as it probably fosters the « herd instinct » and the « herd

behaviour » which are one of the major problem we have today to cope with.

Thirdly, we are experiencing in Europe economic developments that are fostering major changes in the present mood which is still too « malthusian ». I see three main reasons for such changes in the european psychology : firstly, major structural reforms have been launched- the single market, the single currency- ; secondly, a technological wave without precedent is boosting, not only the vibrant information technology sector, but also the full body of the economy ; and, last but not least, steady growth is now confirmed here.

In that environment, a significant number of enterprises encounter difficulties in recruiting employees and we observe scarcity of skilled labor. According to the most recent survey, this is the case for 35 % of the French enterprises. Not surprisingly, we also note that, in spite of the recent dynamism

in fixed capital investment, the stock of capital is still insufficient, taking account the pressure of demand at the present level of capacity utilization rates. Not only have we got evidences that the economy needs more skilled labor and more capital but the full body of the society is now convinced that an acceleration of productivity is welcome.

Central banks of the Eurosystem, and the Banque de France in particular, are steadily antimalthusian. We call for more skilled labor -including by unleashing additional hours- more investment –it is, more than ever, time to invest- and a speeding up of productivity.

Because eliminating inflationnary bottlenecks is decisive to improve the non inflationnary growth potential and therefore to consolidate job creation and foster further diminishing of unemployment.