Monetary Dialogue of the Committee on Economic and Monetary Affairs of the European Parliament with the President of the European Central Bank, in accordance with Article 113(3) of the Treaty on European Union

21 May 2002

Mrs Kauppi (EPP/ED, FIN)

Mr Duisenberg, in your testimony, you concentrated on the domestic situation in the euro zone. Like in all the previous testimonies, you have argued that the domestic foundation of growth in Europe is solid and you seem very confident that it is only the strength of the recovery which is still uncertain, but that there is still some recovery happening. Some signs, which were pointed out by the monetary experts which we have been listening to in the Parliament, suggest that a big contribution of consumption and investment growth is still a major factor. Also, the increase of unemployment and recent acceleration of inflation, whether it is temporary or not, have hit consumer confidence. And in some of the situations the purchasing power of consumers might have decreased over the last few months. If you link all of these negative factors to the recovery with the worries which concern Member States and their lack of delivery of structural reforms, how can you be so sure that the crisis is definitely behind us? Can you once again list what are the clear signs that recovery is actually happening and how you can help us to get Members States to deliver the structural reforms?

Mr Duisenberg

It seems to me that the factors you mentioned are precisely the factors that we have in mind when coming to the conclusion that the recovery is slow and the strength of it still is uncertain. The factors we are looking at which give us reason to be, nevertheless, rather optimistic on the outlook are, first all of all, the indications we have on business confidence which has been on the rise in recent months and now supported also by the first data on industrial production which is, albeit slowly, on the rise again. They are the factors that support our assessment, for which I should also like to refer to the twice yearly Eurosystem staff projections, which we publish in June and which support our view that the recovery is there and that it will be slow. What can be done to enhance the structural reforms which, according to every analysis anywhere, is badly needed? Without saying that nothing has happened, some significant things here and there have

indeed happened, but there is still much more to be done. It differs from country to country what precisely is needed. I think the major factor that we should look at, and then we can do not much more than open our big mouth to enhance that, is increased flexibility in the labour market, not only on the demand side, but also on the supply side.

Mr Goebbels (PES, L)

Two questions. First of all, when I saw you walking along the roads of Aachen in your socks, I and lots of other people wondered whether that was a run-up to a softer monetary policy. But joking apart; I can see that today you are maintaining your big goals and one of the big messages seems to be the need for higher productivity levels in Europe. Productivity for whom and at whose expense? You talk about wage restraint but I haven't actually heard you preaching any restraint for the people who hold big capital who may be calling for a big return on their investments to the tune of 10-15% without the Central Bank finding that at all excessive. When will the moment come for the workers to have their share in productivity gains? That's the first question. Secondly, everyone knows that the US has a big commercial deficit and at the moment it is approaching 2 bn dollars a day. Do you agree with Treasury Secretary O'Neill that this is a deficit without importance, or do you agree with Mr Greenspan that this in the long term is an unsustainable deficit, as Greenspan said last December.

Mr Duisenberg

I think that the period of great wage moderation, which has lasted for about 5 years, has shown that through a drastic increase in employment , one could say that workers have had their share in productivity gains in the form of more employment. Unemployment over a period of 5 years has come down from more than 10% of the working population in the euro area to, at the moment, 8.4%. It should also be borne in mind that the remaining 8.4% is largely - if not completely - of a structural nature that has to be attacked by structural reform measures supported by a continuation of the moderate wage development, which should not, on balance, exceed in real terms the rate of growth of productivity. Now, the re-emergence of the so-called twin deficits in the US is a source of concern. In the US, the previous administration had concluded a sort of a contract with the congress that they would eliminate the public debt through a range of years of surpluses over a period of 10 years. Now the deficit has re-emerged and that, together with the huge deficit on the current account of the balance of payments, adds to the assessment of the uncertainties that we feel about the future developments of output and prices, including exchange rates.

Mr Huhne (ELDR, UK)

Perhaps I could shift away from asking you about the specific short-term outlook and ask you to point to the way in which policy is conducted . The first is that we took a certain amount of evidence from Mr Noyer and Mr Papapademos on their views of the evolving transparency arrangements of the ECB and I wondered if we could perhaps hear from you, since we've not had a statement from you or the governing council on the Parliament's proposal last year that there should be publication of anonymous votes, first of all you hold votes on monetary policy and secondly that the balance of those votes should be published in order to guide expectations more effectively within the market. You will notice that that's not calling for the publication of individual named votes, but it's calling for the anonymous publication of the balance of votes in order to guide the markets and I wonder whether the governing council had discussed that proposal by the Parliament since there was no mention of it in the annual report. Secondly, going on the framework issue, if we look at current developments with the stability and growth pact and particularly the extraordinary promises of the current president of France that he will have tax cuts and public spending increases despite the commitments which he entered into at the Barcelona summit, whether you thought it was time to reinforce the framework of the stability and growth pact. I'm particularly thinking of using a cyclically adjusted measure of budget balances as an operational target since I now understand that the ECB, and indeed the finance ministries, have come to a common methodology on how to calculate cyclically adjusted budget balances and maybe the position in Germany, and possible problems in France, could have been avoided if we had had an operational target of cyclically adjusted budget balances which might have headed off excessive relaxation during the good years and therefore have stopped reaching the 3% in bad years.

Mr Duisenberg

The judgement of the Parliament after last year's annual report of course was discussed in the Governing Council, but the Council did not change its mind. Publishing balances of votes presupposes, first of all, that you vote, as you indicated. If in a discussion on monetary policy it becomes clear that there is broad consensus amongst the participants in the discussion then, why vote? Hence, it would be difficult to publish the balance of votes. Moreover, I don't believe that, even if we were to vote, which I don't exclude for the longer term future, especially after enlargement of, the Euro area, publishing the balance of votes might be more necessary than it is today. I don't exclude that, at that time, voting becomes a more normal attitude or procedure

followed in the Governing Council, and, as a consequence, also the so-called anonymous balance of votes might be published. But my question remains: whether that would give clarity to the markets or more transparency than is the case now when explicit and extensive accounts of the Governing Council's discussions, in particular on monetary policy, are given to the markets and the public immediately after the session of the first monthly meeting of the Governing Council. On the same day we also publish on our website the questions and answers raised during the press conference immediately thereafter. On the Stability and Growth Pact, I can be brief, Mme Chairman. I am not in favour of changing the rules of the game when the game has only just begun. Although there may be merits in giving more attention to a cyclically adjusted measures of the budget deficit, the uncertainty surrounding these measures are still so great, in particular the difficulties in arriving at a universally shared view of what is precisely the cyclically adjusted deficit, that one may be very hesitant to set aside our present methodology which concentrates on the nominal deficits as they are being published and recorded in practice. Mr Huhne, you mentioned two countries in particular, among which France. I am not in a position to comment on the Fiscal position in France yet because, so far, I've heard only words and seen little action. What I do see is that the first thing that the new French government has done was to order an audit of the public finances in general by the same audit committee that performed the same exercise when the previous government, the Jospin government, came into power. It is the same audit committee that is now investigating the public finances of that country. A final outcome of this audit cannot be expected before the general elections in June. So the final outcome will have to be judged on by the new government, which will be in power after the mid-June election round.

Mr Huhne (ELDR, UK)

I have a follow up on the first answer: On the consensus issue where you say that obviously you are taking decisions without taking a vote, you have been criticised very heavily on the markets and elsewhere, I think unjustifiably, but you have, for slowness of decision taking. If you take decisions by consensus, rather than by vote, by definition you are waiting for the slowest ship in the convoy before you take those decisions. Do you think that has actually led you to take decisions on interest rates more slowly than if you were taking decisions by a vote?

Mr Duisenberg

I tend to agree with you when you say that the criticism that has been uttered was unjustified. Wehave been making monetary policy for 31/2 years, and I can remember no occasion when we

took a decision which we thought we would have taken earlier. Allow me also to point to the very quick decision after the September 11 events in the US, which happened on a Tuesday, and the Monday thereafter - in concert with the Federal Reserve system - we decided as an exceptional - and also exceptionally quick - to lower our interest rates by 50 basis points. A lowering which otherwise would, to my mind, also have taken place, but later. It was this specific event which brought us to a very quick decision indeed.

Mr Lipietz (Greens/EFA, F)

You have made rather an odd speech for a President of the ECB. You explained that the M3 monetary aggregate, the first pillar, is no longer particularly significant as far as lax monetary policy is concerned, but indicates a preference for liquidity because of uncertainty. As for the second pillar of monetary policy, you went on to say that there is no link between monetary policy and short-term growth in prices. Then you concentrated on criticising other peoples' policies, either policies of the states which have too high budgetary deficit or the businessman not making enough technical progress or productivity gains or the trade unions asking for too many wage increases. Of course, people may share your criticism, but at no point did you say why and how these three groups of people accelerated, or risked accelerating inflation. In the Mr Noyer's report last month, trying to explain the acceleration in inflation over the last 18 months, only two groups of issues were quoted - land productivity in particular livestock problems and the problems in oil. Again linked to land - the work or capital factors was never mentioned in the ECB report. I think Mr Noyer's report did speak sense in the current situation. You have got a crisis affecting the land factor the work and capital factors must try to adjust by either reducing production, or increasing prices but I don't see why, under these circumstances you are continuing to stress exclusively the flexibility of labour and bringing down the cost of labour without mentioning land or capital.

Mr Duisenberg

I beg to disagree. In explaining the disappointment that we have experienced in actual inflation figures for the first months of this year, I have explicitly referred to oil prices and the impact of foot and mouth disease and other veterinarian diseases, as well as the impact ofbad weather conditions in the first months of this year, particularly in January, as explanatory factors for inflation decreasing slower than we had anticipated earlier. What we do hope is that these factors, some of them are by definition of a temporary or one-off nature, such as the bad weather, are behind us. Think also of the animal diseases, that we hope are behind us. We hope

also that oil prices - and future oil prices give some indication for that - may come down again, so that the recent increase in oil prices will prove to have been of a temporary nature. By no means did I or do I ignore them. I distance myself from the summary you gave of my statement as if M3 was no longer significant. On the contrary, M3 or is a kind of shorthand for a range of monetary developments. I mentioned development of loans to the private sector. I mentioned also component parts of M3, like M1 and M2, credits to the governments. They are all being judged and, in the end, the judgement is that the strong growth in the overall M3 that we have seen over the entire past year and that we are still seeing in the first few months of this year has given rise to a liquidity situation which certainly can be characterised as being ample for the economy as a whole. In other words, you could say that with ample liquidity situation and real interest rates which are lower than they ever have been in the past of the euro area, or before , I believe since the war, financing conditions are favourable. Given that the liquidity situation is ample, in a time when the recovery seems to be on its way, this raises for us the necessity to remain vigilant with regard to future developments in prices, although there is no cause or reason for alarm. We still do think that the monetary policy stance that we have is appropriate for the time being and given the outlook, as we are seeing it over the medium term, of developments of prices, we still are of the opinion that inflation will fall further in the course of this year, but we no longer think that inflation will be very much or safely below2%, but on average we expect it to be around2%. It could be just below or just above, but we do expect inflation to fall somewhat further next year but that all does depend crucially on the hypothesis that wage moderation, which has been so successful in the past in helping to create employment, will continue.

Mr Lipietz (Greens/EFA, F)

I don't think that you've answered my question. Why, every time there is an oil shock or an agricultural crisis, do we have to respond by reducing salaries or flexibilising salary costs?

Mr Duisenberg

Monetary policy does not react to this short term temporary environment. I also do not expect wages to react to these temporary and one-off measures.

Mr Herzog (GUE/NGL, F)

Two questions. First, I think you are overstating the risk of inflation by particularly referring to wage costs. What about the uncertainties hovering over this situation, internationally speaking

the climate is not good. And as for internal demand in Europe, it's not doing all that great either. Therefore, I would tend to think that reasonable wage increases would be good for sustaining internal activities and internal demand. It does require that. As for the international situation, which is one of limited growth and where the dollar will probably go down, which will probably lead to deflation in Europe, leads me to a completely diagnosis of risks attached to wage rises. My second question relates to your view on the midterm. I agree with the need for increased productivity, but how do you explain the following: how will budgetary balance by 2003 or 2004 plus flexibility in the labour market, and I , lead to increased productivity. An analysis of Europe's shortcomings in terms of productivity requires that we also look into research, development, networks, education and so forth where we need public and private investment. I think there is a huge contradiction attached to your diagnosis, Mr Duisenberg.

Mr Duisenberg

I must confess, I didn't quite understand the question in your second remark; but on the first: do wage increases help sustain demand? Yes they do, but they also have another effect. They increase costs and therefore they hamper the further creation of employment and costs will undoubtedly be turned over to the ultimate user in the form of higher prices. We judge that danger as being distinctly larger than the benefit to demand that wage increases might have, as I indicated in my introductory remarks. It is true that the recent appreciation of the Euro, vis-à-vis the dollar may have a dampening effect on further wage developments, and that is welcome. After all, since the beginning of this year the Euro has appreciated by 5-6% in nominal terms and that may help contain the inflationary pressures in as far they are there. That is a beneficial side-effect.

Mr Herzog (GUE/NGL, F)

How can we increase productivity by imposing short-term budgetary balance where you have a general context of slow growth, limited growth when you need more investment in research, networks, etc. Productivity doesn't mean just more flexibility in the labour market, which just leads to precarious jobs and more intense labour.

Mr Duisenberg

I would like to point to three countries: the USA, the Netherlands, and Ireland, which all have gone through a period of bringing their budgets in order and have even created surpluses whilst at the same time experiencing rises in productivity which were unprecedented. Thus, a sound

fiscal policy and an increase in productivity are not mutually exclusive, on the contrary: there is evidence that productivity growth can be achieved at the same time whilst bringing your house in order as far as the budget is concerned.

Mr Blokland (EDD, NL)

I'd like to put a couple of questions to Mr Duisenberg on the problem of price increases and inflation. These are problems which you already approached today and this is something which we discussed with professor Norbert Walter last week. The Euro was introduced most successfully. This is something of course we debated in January, and indeed at that time we, or at least some of us, suggested that there had been price increases but after a few months have passed, generally speaking, the public opinion seems to believe that there have been substantial price increases linked to the introduction of the euro. Now, the first kind of opinion poll carried out, is to ask your spouse, and my dear lady wife has said to me that what you pay out in cash in the shops is greater now. This, if you want to buy an ice cream in the corner kiosk in Germany, or wherever, one ice cream cone with one ball of ice cream does not cost one Mark, it costs one euro. That's twice the price. Now the impact that this has on people's purses and pockets is pretty substantial, I would suggest. Furthermore, I'm sure you know that people's spending is very fragmented. Small amounts are being spent hither and yon, so one's shopping basket is made up of a number of different products which are viewed differently, but, basically, it's difficult to explain to people that the euro is a good thing. I mean, in Germany a large number of people want the Mark back and in the Netherlands there is a large percentage of people who want the Guilder back. Believe it or not. So what are we going to do? How can we recover people's confidence How can we do about this believe that the euro is a bad thing and that it has led to increases? Can't there be some kind of independent research which proves whether there has or there has not been an increase in prices attached to the introduction of the euro? There is a 4.2 % inflation in the Netherlands but there has been a decrease of inflation from 2.9 to 1.6 % in Germany. But in Germany, people do have the impression that prices are on the increase as a result of the introduction of the euro. So perhaps we could have a thorough analysis of this.

Mr Duisenberg

I do admit that our and Eurostat's assessment of the impact of the cash changeover on price developments differs markedly from what the general perception amongst the public at large is. And that is a problem. I admit that, and I also say that if you make a so-called independent investigation, it will be increasingly difficult to change that perception. I know it has been done

in the Netherlands. It has been done in Spain. With strikingly different results, by the way, in those two countries. It will be repeated by some central banks in the course of this year, but one should not overlook the fact that the official inflation figures, as for example, you just quoted them, encompass a package of goods and services which is far wider than the package that is included in you wife's shopping list. And there have also been marked demonstrations of prices coming down. Think, for example, of personal computers. In particular goods that are not being bought every day, they show a tendency of prices coming down, also thanks to the introduction of the euro which so greatly increases the transparency across this huge market of 300 million people. We will continue to follow price developments as a result of the cash changeover. I would also like to add, while admitting that we have a problem of perception here, two remarks. One : the process may not even be over yet. Price increases may already have started in some sectors in the course of last year, in the sense that firms used the forthcoming introduction of the euro to already increase prices before notes and coins were available and it may still be going on. But it will be increasingly difficult to distinguish the causes of certain inflationary tendencies from each other. There will be times that the weather conditions will be against us, then there is again a oil price hike, then there is another factor which may come into play and I do strongly believe that we are still in a period of transition. The tendency for the public at large may also to some extent be to use the euro and its introduction as a sort of scapegoat, blaming the euro for certain inflationary tendencies which may originate in totally different or other phenomena. But then also the introduction of the euro, luckily, was a one-off event. Thus, I do believe that the perception regarding price increases as a result of the euro will fade away over time and the best thing we can do to increase or restore the confidence that the public has in its new currency is to deliver what we promise to deliver, namely price stability. And that, as such, will and should be experienced by the people. Over time, I do believe, it will be highly valued.

The Chair, Mrs Randzio-Plath (PES, D)

Many thanks Mr Duisenberg. Before I give the floor to Mr Blokland for a supplementary question, let me just say that there was a problem here; we in European parliament wanted secondary legislation to be adopted in this area, but the Finance Ministers said that the principle of subsidiarity should be applied. We did see voluntary agreements with the ministries, consumers associations and the retail trade and the result would seem to be that voluntary agreements did not seem to work. There was concern about this, and there is continuous cause for concern.

Mr Blokland (EDD, NL)

Thanks very much. Thank you for these replies, Mr Duisenberg, but a supplementary question springs to mind. Looking at it afterwards, and of course hindsight is always 20/20, would it not have been better to have chosen a different date than the 1 January? How about the 1 June ? There are a lot of companies who change their prices and rates on the 1 January. Perhaps it would have been a lot easier to get a genuinely good idea of the impact of the euro. Then there were the voluntary agreements. Wouldn't these have to be improved upon? Perhaps toughened up and maybe we should have included sanctions as well, because very gradually, we see what is happening and it is a bit worrying.

Mr Duisenberg.

Well, whether it would have been better to have another date, we will never know. The 1 January, of course, is also a date at which many administrative prices, including indirect taxes are being changed, normally, in every country, and that also has happened this time. That has, or is even meant to have, an upward impact on inflation . Hence, the introduction of the euro is being blamed for the increase in prices that had to happen anyway. Wouldn't it have been better to chose another date? I honestly do not know. What would have been better, I think, is, as has happened, in some countries, but not in all, to start dual prices much earlier than has happened in some countries. In my experience, in France dual pricing has happened at a very early stageand the people had the opportunity at gas stations, in supermarkets, to get to know the two prices and compare them, at a much earlier stage than in some other countries, for example in your and my country.

Della Vedova (Non-attached, I)

Is there not a need for the Central Bank to call on member states not to settle with the agreed reforms and liberalisation - not just to stop there. I think that the climate in Europe is, in fact, deteriorating in this respect and there is the risk that we will have markets that close in on themselves. As I said, I feel we must keep repeating that the advantage of the single market and euro will be seen when we have genuinely competitive markets. What are the companies' investors calling for. They are asking for a market that is generally competitive, which, in fact, gives the best possible income. What is your opinion there?

Mr Duisenberg

In my introductory remarks I did mention apart from labour markets also products and services markets, especially also markets for financial services. I do believe that for the future development of the euro area economy and to realise the goals set by the Heads of State and Government in Lisbon and Barcelona, structural reforms are indispensable. Also, indeed in the other markets than labour markets. We will not be able to reap the full benefits of the single currency if financial markets are not better integrated. In that respect, the Lamfalussy report is a great help to reach that over time. Apart from the financial markets, in terms of product markets, making shopping hours more flexible is a very simple, but highly politically sensitive issue in some countries, but it would certainly help also to increase flexibility.

Mr Karas (EPP/ED, A)

I do get the impression that you are very optimistic, Mr Duisenberg, but equally you have a lot of questions. Perhaps more sources are concerned than in the past. You are optimistic and yet on the other hand you are concerned about a series of external questions, economic policy in the U.S. and then there is the question of achieving certain aims for our own internal policy. I would like a bit of clarity on some questions, if I may. What do you believe the impact of the changes in U.S. economic policy is going to have upon economic policy and in particular in the euro zone. You mentioned integrated financial markets as well. What role do you think the ECB could play in creating a new type of supervision for these integrated financial markets? Then, you addressed a number of demands to member states. As you know the convention is underway, what kind of request would you put to the convention to try to improve the situation on that front and the role of the ECB?

Mr Duisenberg

What precisely will be the impact of changes in U.S. policies on Europe? First, I have not seen such dramatic changes in U.S. policies. I can go no further than saying again that in particular fiscal policy adds to the uncertainties that we see, it adds to the fragility of the recovery. The re-emergence of a deficit in a country which was determined to have ten years of a budgetary surplus adds to our uncertainties and makes the prospects for a sustained recovery more vulnerable, but then again the U.S. has surprised all of us. It has shown a rapid rate of increase in GDP growth in the first quarter (5,8%), which certainly will not be repeated in the second quarter. Butpositive surprises can come as well. It all shows that the uncertainties which I mentioned are there. Turning to your question regarding the role of the ECB in financial market integration and, related to that, the Convention; the Treaty gives the ECB the mandate to

contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. We try to fill in that mandate by strengthening our Banking Supervisory Committee (BSC), by making it more independent, or even totally independent, from the Governing Council of the ECB, and maybe even letting it report no longer to the Governing Council, but also, or primarily even, to the Ministers of Finance. There is one important element in the various proposals for restructuring the co-operation in supervision and oversight. We do strongly believe that it is in the interest of the people if in that restructuring, all central banks will remain involved. Even if they are not directly in charge of the limited area of banking supervision, they are all in charge of promoting financial stability. I do believe that especially in crises situations, the closest possible co-operation and exchange of information between supervisors and central banks is necessary in order to solve the crisis when the supervisor has overlooked that it was about to emerge. Our proposals, at the moment being discussed in the Economic and Financial Committee and by the Ministers of Finance, is, as already referred to, to have a much more independence, but only one, committee which could report to the Ministers. It should include all supervisors and all central banks of the European System of Central banks. As far as the Convention is concerned, we follow the work closely. We are not ourselves a member of or part of the Convention, but we will not hesitate to give advice on certain issues, whether asked or not, if relevant changes are being contemplated. The one factor that we as the ECB are working hard on and that might come up at the Convention relates to the accession of a significant number of countries, first to the European Union, and at the same time to the European System of Central Banks, and at a later stage, maybe years later, also to the euro area. That may require, I am not sure yet, a change in the decision-making process, especially in the Governing Council. We are at the moment not ready yet with our work on this issue. We are at the moment working on a proposal. In that proposal we are working towards some form of rotation mechanism, but we want to uphold, at the same time, some basic principles underlying the current functioning of the Governing Council, i.e. the personal independence of its members. That, by the way, already excludes the possibility mentioned by the European Parliament of trying to form constituencies, because in a constituency set-up the members that for the time being had a vote, also on behalf of others in the Governing Council, would be accountable to and would have to listen to the people they represent. It isfor that reason that we are investigating other possibilities, but I can assure you it is very complicated, of some sort of rotation mechanism in a greatly enlarged Governing Council in order to make at least the voting procedures less

unyielding than they otherwise willbe. We have to, as the Governing Council, be unanimous in coming up with such a proposal.

Mr Ettl (PES, A)

I am from a country that actually lives up to your prescriptions. We have a zero deficit on the budget and nevertheless, or perhaps, for that reason, unemployment is rising and we can feel the inflation rate which is related to the introduction of the euro, but that is simply the fact. There is a psychological effect behind what is happening. Now my first question is: Within the euro participants, we have countries with even more problems with the implementation of the stability pact program than we do. For those who cannot keep up, we see that the economic framework that we have at the moment, are finding it very very difficult to catch up. It is even more difficult than it was. That is the present discussion. Now, do you have some concrete ideas about how we can help the countries who have fallen behind? How we can help them cope with the problems of the stability pact? Are we going to see this problem cropping up again when we add more countries? Because with the stability pact we see there is less consumption and a different attitude to consumption - so what is your idea there. You talked about structural unemployment. That is true to some extent because we are restructuring Europe's economies but the fact is that purchasing power is not making up for this and is not giving the impetus that it should do, and this is linked to the stability pact. The weakness of the purchasing power has something to do with the stability pact and unemployment is not just structural. It is all linked and this leads me to the next question that recently, we have heard a lot of talk about interest rate increases. We think that would be madness with the present framework. We could not face interest rate increases. So, the question is whether you do not have the same thesis as I do and that is with this framework the raising of interest rates would be more than counter-productive at the present situation.

Mr Duisenberg:

The first question was how to help countries that have difficulties in meeting the requirements of the Stability and Growth Pact. I assume you are referring to the budgetary situation of these countries. I do not think that in the context of the Stability and Growth Pact,there is anything other than what the countries themselves can do to help them to meet the targets. But then again, I go to virtually every meeting of the Eurogroup, and I have never heard a finance minister say, also not in the most recent meetings, that they would shy away from meeting the targets they have set themselves in the context of the Stability and Growth Pact. On the

contrary, I have heard, and I have listened to it with gratitude, the determination from all sides to live up to the self-imposed discipline that the countries imposed on themselves when meeting in Dublin, I believe. I do take issue with the thesis that unemployment would rise if a country meets the goals of the Stability and Growth Pact. I mentioned some countries already, including my own country that has gone through a period of close to fifteen years in getting its budgetary house in order, and which is now experiencing a surplus in the budget. During that same period, the rise in employment has been larger than ever before in history and in Ireland you have seen the same thing. So there is no automatic link between rising unemployment and meeting the criteria of the Stability and Growth Pact. On the contrary, I believe that to create a macro-economic environment which shows stability, continuity and determination on the part of the authorities regarding the Pact, is the best contribution that these authorities can make to the creation of employment and fostering economic growth.

Mrs Riis-Jørgensen (ELDR, DK)

I would like to follow up on the question relating to the convention. Over the weekend, the French newspaper "Le Monde" referred to the Commission proposal for the convention on the future of Europe. What I read in "Le Monde" was that the Commission would be proposing changes to the decision-making process on the economic and monetary co-operation. In the light of the question whether Germany should have been given an early warning for not complying with the budgetary objectives, it was very interesting to see one of the Commission proposals because the Commission is supposed to be proposing that they should have sole competence in the future. That is without actually involving the Ministers of Finance and Economies of the countries. They would be able to set out the general economic guidelines so they could decide whether early warnings should be issued to member states that do not actually comply with the economic objectives that have been set. This, of course, is something that has not been made public by the Commission yet but, nevertheless, how would you look at such as proposal if it came out and if the intention was to strengthen the role of the Commission in economic and monetary co-operation.

Mr Duisenberg

I look upon the proposals with sympathy, provided they do not encompass also exhaustive co-ordination of monetary policy. That would place the monetary authority, i.e. the Governing Council of the European Central Bank, in an impossible position, given that itsprimary task is to maintain price stability. If the ECB were to be included in exhaustive co-ordination it would

have to compromise its own mandate in an, to my mind, unacceptable way. That is not to say that the European Central Bank will not engage in a dialogue, even a continuous dialogue with other policy-makers. The advantage of that dialogue for other policy-makers, fiscal policy and economic policy in general, is that they will know, when they formulate their policies, what the policy of the monetary authority is and will be. On the early warning, allow me a short retrospective remark. When the Commission considered to propose to issue a so-called early warning to, in this case, Germany, the Ministers of Finance did not take over that proposal. Why did they not do that? For two reasons: First the German budget was threatening to go in the direction of the famous 3% limit, but it was not there yet. For that reason an early warning was to be issued. However the German Finance Minister, i.e. the German Government, stated that Germany will not exceed the 3% limit. Secondly, whereas an earlier proposal had been to postpone to a future date, say to 2006, the day at which Germany would reach the position of having its budget close to balance, or in surplus, the German Finance Minister withdrew that proposal and committed the government to stick to the goalsset earlier in the broad economic policy guidelines, i.e. that Germany will reach the required position of being close to balance in 2004. When the Ministers of Finance heard that, they decided not to adopt e recommendation. The peer pressure had worked and that is the main characteristic of the instruments included in the Stability and Growth Pact, i.e. to exert peer pressure. . Unlike as some commentators suggested, to my mind, and I was present, the Commission did not give in or was not defeated. The Commission acted as a catalyst to extract this policy intention of the German Government from the German Government in, I am inclined to say, a very successful way.

Mr Purvis (EPP/ED, UK)

I would like to follow up on that particular situation - that is the validity of the stability pact and all that goes with it. You said the French President's remarks were only words and you would wait for action, so far. You say the Germans have determined to do something but that is only words so far too, not action. Are you confident really that the stability pact, I mean there are other, the Chancellor of the Exchequer in the UK has bridled at being criticised for his intentions to go into deficit financing and this seems to be a fairly common State's rights sort of attitude that is springing up around the table. Can you as President of the ECB give them fair warning that if they do not observe the stability pact in action as well as words, that you will use all the powers at your disposal on the monetary side to defeat any such defiance, and would you be prepared to give them such a warning right now.

Mr Duisenberg

If I am not confident, then I am at least hopeful that the Stability and Growth Pact will work. But I have to remind you that the term ECB or central bank does not appear in the Stability and Growth Pact. We are not a part of it. Thus, all we can do is, and I say it again, as I said to the question posed to me by the rapporteur on the ECB annual report, to open my big mouth. But specific actions, we would take only, not because one or two other countries were not to fulfil their obligations , but from a euro-area perspective. That is apart from our public verbal interventions.

Mr Purvis (EPP/ED, UK)

If you are prepared to take these interventions in action…

Mr Duisenberg

Verbally!

Mr Purvis (EPP/ED, UK)

Not just verbally, but in action, if the stability pact is not observed. Then presumably there is no real purpose in the stability pact as far as you are concerned. It is a good thing, but if it is not observed it does not really matter. You will take the necessary action anyway.

Mr Duisenberg:

If we take a monetary policy decision it is based on an assessment of future developments in the entire euro area and not in just a single country. We have a single currency. We have a single central bank. For the single currency, we have an area of 12 countries and 305 million people and then, if one, or even two countries were not to live up to their obligations, we would join the peer pressure, but monetary policy decisions will never be based on the developments in one country only.

The Chair, Mrs Randzio-Plath (PES, D)

Was not the monetary policy of the ECB too rigid? Could the ECB not have helped us to have stronger investment-led growth on. Even if monetary policy does only have effects in the medium term I think we should not underestimate its psychological effects. This is something that the International Monetary Fund's economic outlook in fact raises and I would like to know why you have rejected this criticism of the ECB. As a matter of fact we have seen that in the

European Union structural reforms alone have not succeeded neither in helping to combat unemployment nor in contributing to greater growth. We need investments and therefore do you not believe that a more determined attitude of monetary policy could have helped us or - more concretely - would more determination not have been possible if interest rates had been lowered even below the level that we saw last year.

Mr Duisenberg

We have a monetary policy, Mme Chairman, allowing for an ampleprovision of liquidity. The economy is, so to speak, awash with liquidity. In that sense, the monetary policy is already lax. Over the medium term, monetary policy will not help accelerating output. Over the medium term, monetary policy will only influence monetary developments, i.e. inflation. We have a policy which, as I mentioned earlier where - and that matters for investment – resulted in real rates of interest (nominal interest rates corrected for prices) which, at the moment, in the euro area are in a range of 3.1% to3.5%. In the period from 1981 till 1990, the real interest rate in Germany was 5.1%, at that time the lowest in the European Union. During the period 1988 until April 2002 the real rate of interest in Germany was 4.6%. At the moment it is 3.1%. I cannot imagine a better contribution to the resumption of investment than wegive. Moreover, empirical evidence shows that the so-called interest rate elasticity of investment is relatively limited. Indeed,profit and turnover expectations determine the resumption of private investment and not so much the cost of the investment.

The Chair, Mrs Randzio-Plath (PES, D)

Well, nevertheless, it is a fact that the investment rate in the USA. lies way above the level in Europe and here, often psychological effects play a greater role than the real circumstances and, of course, we should think that if you look at the productivity development in Europe, then we can certainly measure up to the United States. And we will catch up as soon as the financial action plan is implemented. But I do not know whether the return aspects are so relevant. Yes, in the United States this effects the development of profits, but in the EU it results mainly in reducing working hours for workers, so we have two competing models we have to discuss. Perhaps we should for this particular reason have a different monetary policy also - different from the one in the United States.

Mr Duisenberg

I do believe that we have a different monetary policy in Europe, but then we establish and set our monetary policy stance exclusively with a view to developments in the future in the euro area. I do think that, comparisons of the monetary policies enacted respectively by the European Central Bank, i.e. its Governing Council, and the Federal Reserve System, may not be appropriate for economies that are so different in structure.

Mr Huhne (ELDR, UK)

Perhaps I could just ask about your views on the constituency system as a potential for taking decisions within the ECB. Surely you could have the constituency system as a way of selecting members of the governing council, but it would be understood that their mandate would still vote individually. Effectively, it would be like an electoral college. You would not need to have them as representatives of the constituency so there would not be an inconsistency between the constituency system and the need to have individual mandates focused on the euro area as a whole.

Mr Duisenberg

Are you suggesting that under a constituency system, there would be certain countries which would not be a member of the Governing Council?

Mr Huhne (ELDR, UK)

That would obviously be to discuss. I would personally allow all central bank governors to participate in a speaking capacity, but when it came to the votes the constituencies would be grouped together and would select one person who would vote. But they would vote on the basis of their mandate today i.e. for the euro area as a whole and it would be understood that they would be voting for somebody in that way.

Mr Duisenberg:I have had the experience with a constituency system for almost 20 years - 15 years as Central Bank Governor and 5 years as Minister of Finance - in the context of the IMF, where I headed a constituency consisting of about 10, later 12, countries, namely the Netherlands, a lot of Central and Eastern European countries, Cyprus, Israel, Bulgaria, Romania and also members of the former Republic of Yugoslavia. When I or the Executive Director of the IMF, IMF representing all these countries in the constituency, spoke on behalf of the constituency, we always had to consult our membership before taking a position on whatever

issue, be it in the Board of Governors or in the Executive Board. A system where one member of the Governing Council would have to vote in accordance maybe with a majority of his constituency's opinion, to my mind cannot work. The individual members, in voting, would lose their personal independence as they have now. That would not be the case if we can design some sort of rotation system, which would be similar to the rotation system that is applied in the United States in the Federal Reserve System. The Federal Open Market Committee has as voting members, every six weeks when it meets, the seven members of the Federal Reserve Board of Governors, the President of the Federal Reserve Bank of New York, who has a permanent vote, and rotating voting rights for three out of the other eleven Presidents of Federal Reserve Banks. I still have hope, and I do believe, that we will be able to come up with a solution in this respect regarding the voting modalities of the Governing Council after accession, which will carry the support of all members of the Governing Council. If not, then we have to bring the issue back to either the European Commission or even the Ministers of Finance.

Mr Langen (EPP/ED, D)

Unlike our chairman and vice-chairman Herzog, I agree with you on your analysis of competition in the EU. There is a basic misunderstanding here. Interest rates are about as low as they have been for a long time. That is not why private investment has not been boosted enough. It is because of the competition conditions. Salaries were too high, social security was too high. That's what needs to be tackled. That's what the member states of the European Union have to deal with. Nobody will be able to hide that. If you say investment would be higher if interest rates were lower it is an erroneous conclusion. It is not true even after state investment. In big economies, a state makes up over a third of GDP. The social sector is so powerful that state consumption is to the detriment of state investment in infrastructure. That's what needs to be tackled in my opinion. These are the reforms that the member states have to tackle. You cannot blame the European Central Bank's monetary policy for everything. I just want to say that the whole discussion is being led by the left of the house and is leading us to the wrong conclusion. Drop the interest rates and a magical solution will appear. Now you have got to tackle inflation and reform. That is the only way to go. I have a question, Mr President. What are you going to do about the dialogue with the three states in the European Union which are not members of the euro zone, i.e. UK, Denmark and Sweden? What about the candidate countries? Are you in constant contact with their central banks and what is your assessment of this process?

Mr Duisenberg:

We have in a formal sense permanent contact. Namely, all the central banks, including those coming from the so-called out countries, are members of the General Council. In between we have, as Executive Board, intensive contacts with the out central banks, be it on a bilateral or a multilateral basis.Although the members of the General Council are immediately informed about all the decisions of the Governing Council, there still is a feeling of being, perhaps not ignored, but of being not fully aware of what is going on inside the euro system. It is for that reason also that we have intensive bilateral contacts with these central banks, with their boards, with their staff and which are, I am inclined to say, much more intense than they have ever been before the euro was introduced.

Mr Tannock (EPP/ED, UK)

There are claims that the euro, because of its depths and size as a zone, saved the French economy and its currency stability during the asymmetric shock of the recent crisis which developed during the Presidential election, when one candidate, Mr Le Pen, fought on a platform of withdrawal from the European Union and the single currency. Is there are truth in this allegation i.e. does the central bank have any figures from the Bank of France about capital flight from French banks during this delicate period, or is this whole story just another example of pro-euro or single currency spin. A second question - enlargement is now getting very close - 2004 is the possible date - and this is an asymmetric shock as well. How long, on average, does the central bank expect new member states to retain their national currencies after accession? Also, does the central bank accept that a much larger European Union of 27 member states will bring added risks of asymmetric shocks developing in the enlarged euro zone and, if so, will the current 1% GDP EU budget be large enough to mount a rescue package to bail out countries in trouble, who cannot devalue their currency or lower their interest rates after joining the single currency?

Mr Duisenberg

First of all, on France I have no figures, but also no indications that there was a change in the intensity of capital inflows or outflows. For France, the same is true as what is true for the entire euro area, that the tremendous outflow of capital that took place in 2000 and 2001 has dramatically decreased and in some cases it has even turned into an inflow of capital, e.g. foreign direct investment. How long do I expect accession countries to maintain their national

currencies? I have no idea because it may, and it should, differ from one country to another. That would very much depend on the circumstances as they develop in these countries, which to a large extent are also so-called catching-up countries. They have to catch up - according to the Copenhagen criteria - to an economic performance which is more or less comparable to that of the euro area. What impact could an asymmetric shock affecting the accession countries have? I believe that this should always be very limited.We talk about ten accession countries being ready to join the European Union before the elections to this Parliament in June 2004. If there are ten, then these ten - and we know who they are - represent about 5% of the GDP of the current euro area. I do not say it is negligible but it is very small indeed. Will there be a bail-out for accession countries? I believe not. In the Treaty it was explicitly foreseen that currency problems would not be a source for bailing out a country in trouble.

Mr Andria (EPP/ED, I)

I want to talk about the monitoring of the credit system. The Member States all have different systems, but I think that through a monitoring of the credit system, we can also have an economic policy. Let me explain to you that in Italy there has been a kind of crusade to , eliminate the smallest parts of the credit system, . What we see as a result is that this is helping the large banks and the large credit institutions and, in fact, impoverishes the country because the small elements in the system - those who talk to small traders, small and medium-sized enterprises and so on, have no longer someone to talk with . .Maybe the European Central Bank could co-ordinate the monitoring in some ways so that you actually have the monitoring of member states. Let me be more precise. There could be a form of protection from the ECB with respect to the system of credit provision in Member States and the monitoring thereof. There is something I think is obsessive here - that is the question of flexibility. When we often unjustifiably talk about flexibility, we have in fact social difficulties as we have never seen before, -and I am asking the same as Mr Herzog, but we are looking at it from different angles. We look at productivity because there are profit-sharing ideas where, for example, the employees get stock options and also profit-related pay, as in the UK, where you link salaries to productivity and all this could lead to extraordinary results.

Mr Duisenberg

I am afraid I have to disappoint you because the Treaty explicitly and deliberately excludes the banking supervision and competition policy from the mandate of the central bank. That continues to fall, in line with the subsidiarity principle, to the national authorities. The only

thing that the European Central Bank can do, is to contribute to the smooth conduct of policies related to banking supervision and financial stability. It is doing this by fostering the co-operation and exchange of information as much as possible between the various national supervisors and enhancing the co-operation in that area. On competition - I am afraid you have to turn to your compatriot, Mario Monti, rather than to me.

Mrs Peijs (EPP/ED, NL

We have tried to shape the stock exchanges and the markets as much as possible. It is not always been the case in the U.S. The New York Stock Exchange does not want European trade to be able to see American trade on screen in real time. Can you not negotiate with the Fed in U.S. to change some of this?

Mr Duisenberg

What you refer to is not in the mandate of the Federal Reserve System, but in the mandate of the Securities and Exchange Commission. It should be a point of discussion in the new committee that has been set up by the securities regulators, which is now being chaired by our compatriot, Mr Docters Van Leeuwen. I think that is the forum to which you should talk about this.

The Chair, Mrs Randzio-Plath (PES, D)

Thank you, Mr Duisenberg.