Hearing before the Committee on Economic and Monetary Affairs of the European Parliament

20 June 2000

Introductory statement by Dr. Willem Duisenberg, President of the European Central Bank.

Chair:

Thank you very much President. I am sure there will be plenty of questions and I will give the floor straight away to Mr Von Wogau. I would like to remind you that we have chosen a procedure according to which the groups ask a question in order, and so it's the EPP, the biggest group, that kicks off.

Mr Von Wogau:

Thank you very much Madam Chairman. President, first of all I would like to point out that with the most recent interest rate decisions you have departed from your preceding practice. Instead of taking very small steps to increase interest rates, you have taken a decision for 50 basis points, and that's a very clear signal. I would like to say on behalf of my group that I very much welcome this strong step, and the positive consequences can already be seen in exchange rates. This shows that the confidence of the markets in the long-term stability of the euro has been enhanced by this vigorous decision. But, I would like to put a question to you, since the ECB has been active, it has followed a policy which has been decidedly different from the policy of the Federal Reserve. First of all, you followed an interest rate policy which strongly departs from the policy of the US which I think has helped the development of the exchange rate. With the interest rate, there was a fairly big difference in interest rates and that has encouraged investors to invest in the US rather than in Europe because of this interest rate differential. But now you have sent out a clear message on stability, because the inflation rate has reached 2.0% whereas in the US there is tranquillity about the fact that now the inflation rate is fixed above 3.0%. So I would like to put a very clear question to you – I would like to

know why you believe that your strategy in the long-term is better than the strategy of Mr Greenspan?

Mr Duisenberg:

I don't know whether it is better, but the circumstances of course in, which both economic areas find themselves, are totally different. In the US, the problem is how to achieve a 'soft-landing' from periods of over-extension and from more than normal economic growth over a number of years and how to engineer to get back to normal circumstances. In Europe, monetary policy has to support the resumption of sustained, long-term economic growth from a period where economic performance has been sub-optimal in 1998 and first half of 1999, to mention only the most recent period. Now the policies are different, admittedly. I want to point out in the first place that the level of interest rates about which we talk in Europe is still significantly lower than it is in the US. Then you ask: why this increase of 50 base points suddenly, which you applaud, and I am grateful for that, and not continue with the increases of rates in small steps?

First of all, there are signs that the risks to inflation are becoming stronger all the time and they have been confirmed by the release of the latest figures in the course of May. I refer to the monetary data and the increase in oil prices which has resumed in the course of May. This justified a bigger than usual step. I will also not deny that there is also a psychological argument. We were quite convinced that if we had moved by only one quarter percentage point again, then immediately market expectations would have arisen that this was only a step in a series and that further rises could be imminent, even in the short run, and that is what we wanted to avoid at all costs. We wanted quiet, and for a considerable period to come, we don't know how long, but we wanted quiet and predictability for the coming months in the monetary field. That is the other major reason why we decided to increase rates by 50 basis points. One additional advantage, I certainly will not deny that, even though it was not our aim, one additional advantage is that it does seem to have somewhat diminished the significant interest rate differential which existed between the two large economic areas (the United States and the euro area), which is a welcome development.

Chair:

Would you like to ask a supplementary Mr Von Wogau?

Mr Von Wogau:

Yes, I would like to come back to the second part of my question. The fact that you have put up interest rates now could in the medium-term signify that we'll actually have to renounce a certain amount of growth, because that will have a braking effect on our economy. Here obviously, your strategy is based on the constitution of the ECB, and your strategy is different from that of the United States. In the United States, the inflation rate of more than 3% seems to be permitted whereas you decided to act. Now, leaving aside the institutional question and the fixing of interest rates just decided by the ECB, I would like to know what the disadvantage of a strategy would be which, regarding the inflation rate, would be more lax as regards the inflation rate than the strategy you are following?

Mr Duisenberg:

We are convinced that raising interest rates to the level that we have done, now the main interest rates are at 4¼%, in no way will frustrate the prospects for robust economic growth over the 2 years to come. I want to point out that, without associating myself entirely with it, that the OECD for example has forecast that growth in the euro area will be well in excess of 3% both in 2000 and 2001, but they also say that interest rates will have to rise to the 5% level in that same period. Now, without associating myself with that, it demonstrates that sustained growth is possible and even likely with interest rates significantly higher than they are at present. I also want to point to the American experience, where we have seen a period of prolonged economic growth, it seems clearly above the long term potential of the American economy, with interest rates 100, 200, sometimes 300, basis points higher than prevailing in Europe. So, the interest elasticity of economic growth, as you may call it, is not as large as sometimes may have been feared.

Now the second part of your question, if you could help me?

Mr Von Wogau:

What would be the advantage or what would be the disadvantage that you would see were we to allow a higher inflation rate as is now the case in the United States?

Mr Duisenberg:

It is clear we have a mandate. Our main mandate is to preserve price stability. Now what is price stability? We have chosen our own definition. Price stability will be preserved if the annual rate of HICP inflation is below the limit of 2%, thereby reckoning that the measurement bias which may be included in the price measurement will not exceed 2%. And so we are satisfied as long as future inflation remains below 2%, and we are convinced at the moment and with this monetary policy stance that *ceteribus paribus* we are fulfilling that condition, that the monetary policy stance which we have now chosen is appropriate for that outcome. Now, if you were to relax the definition, to my mind, that would be a disaster, because it would give a signal to the public at large, and especially to the markets, that the ECB didn't care that much about inflation any longer, when it is our prime purpose to keep it below a certain level. It would immediately create inflationary expectations amongst the public if we were to relax that attitude, and inflationary expectations being raised would have the result of becoming self-fulfilling prophecies.

So, it is something that I categorically am inclined to withstand and to deny and I will not co-operate in that respect.

Chair:

Thank you. Mr García-Margallo.

Mr García-Margallo:

Thank you President for your explanations. I would like to pick up the points made by Mr Von Wogau. It is clear from your statement that in the year 2001, the role of growth locomotive will fall to Europe, you talked about a soft-landing for the United States. Now, looking at the inflation situation, you can deduce that the forecast is that we will

have less than a 2% inflation rate, and as for imported inflation, well this hasn't had an effect on consumer prices, so I would like to know about wage developments. Wage developments seem to be fairly stable as well, and productivity increases have helped as well and new technologies have helped too. As this is the case, I would like to know whether the ECB policy will be a zero-tolerance policy for inflation or whether instead, given that Europe has to be the locomotive, will you allow a certain amount of flexibility, and if so, within what terms and within which timing? So my question is this flexibility, will it depend on the way in which underlying inflation develops, that is this possible flexibility on inflation, would it be related to an increase in underlying inflation? There are two possibilities. Either you have an anti-inflation policy at all costs, or you see whether you can insinuate a certain amount of flexibility into inflation given that inflation is under control and given that Europe has to have a locomotive role with regard to its economy at the moment?

Mr Duisenberg:

When I talked about a soft-landing I was talking about the United States not about Europe. We are still 'taking-off'. Imported inflation has to some extent worked its way through, but not entirely yet. The rise in oil prices fairly quickly is reflected in the rise in prices for gasoline to be paid at the pump. But, higher import prices also will work their way through in the general consumer price level with a lag which is considerably longer, and we think that that lag may be in the order of about 6 months before that it has its second round effects on consumer prices. And that in turn may have second round effects on wage demands. Admittedly, wage demands in the larger part of the euro area have been moderate and I commend the social partners for achieving this, but not in all parts of the euro area. There are regions, I'm thinking of my own country a little bit, I'm thinking of Ireland, I'm thinking of Spain where there is pressure already becoming very prevalent for stronger increases in wages. Then you argue well, if underlying inflation remains moderate, then you really don't have a problem. To that I would like to respond in the following way.

The inflation that the people experience is not underlying inflation, but is headline inflation and that is what we have to be concerned about also. And then there are many definitions of underlying inflation – the most commonly used is that you exclude from the overall inflation figure the changes in energy costs and the changes in the more volatile components particularly in processed foods, but there are many definitions of that. The big advantage for us using the harmonised index of consumer prices is that it is a uniform measure valid across Europe, and it includes all components that affect the price level for the population at large. At the same time, we of course look at the movements in underlying inflation. I would like to point out that it has been creeping upwards until last month, when it came down somewhat. There is also a further upward tendency to be expected. We do look at underlying inflation, but the main emphasis is on the total measure of inflation, and I personally think rightly so.

Chair:

Now I give the floor to Mr Goebbels.

Mr Goebbels:

Mr President, your objective is to combat inflation and I must say that so far the ECB has succeeded. Over the past twelve months underlying inflation was 0.9%. You have just said that you have to combat imported inflation as well. But there again, for April and May the intra-European inflation rate was below 2%. Nevertheless, you increased your base rates twice, 25 points and then a further 50 points, and I cannot help feeling that by re-adjusting in this way you have been looking more at the financial markets and the external value of the Euro than at your principal objective which is to combat inflation, so I would like you to react to that.

In your two-pillar strategy you also take into account monetary aggregates and the development of M3. Is that really a good indicator for measuring the risk of inflation, when one knows that according to the ECB bulletin of April last a significant proportion of monetary market titles are held by non-residents. Thank you.

Mr Duisenberg:

I understand, Madam Chairman, that Mr Goebbels thinks that the exchange rate has become more important in our considerations. It has not. The exchange rate is only important to the extent that the prolonged depreciation, as we have witnessed, works its way through in the inflation forecasts which we make. The figures for April and May are again below 2%, which is gratifying, but they are not the main figures we look at. We look at the figures about 1½ years from now. What we expect them to be at that time in our forward-looking assessment. Over this horizon, exchange rate movements will still work their way through to the price level. We believe we have taken adequate measures and appropriate measures to counteract that influence. But it is a forward-looking policy which we exert and although I did not like, and that's no secret, the continuous, to my mind, overshooting downwards of the exchange rate, it is very gratifying that, although its only 3-4 weeks, that movement seems to have stopped and seems to have been partly reversed. What I did not like about it was the undermining impact it had on the credibility of our currency and of our policies and the psychological appreciation of that amongst the public at large. Now with the inclusion of Greece since yesterday evening, close to 300 million people were led to believe that they had a weak currency, totally erroneously, but still the feeling was there, and so for me it is very gratifying that that movement seems to have been stopped, if not reversed. Of course, the exchange rate is an important indicator, co-determining under our second pillar our monetary policy stance. I say co-determining and only to the extent that the exchange rate movements work their way through to inflation and in the inflationary expectations of markets and of the public.

Now, is M3 a good measure? First of all, I would like to point out that when talking about the first pillar of our monetary strategy, indeed we put emphasise on the development of M3. We do believe that money matters in the economy, but I can assure you that it is not only M3 we look at. We also analyse developments in other monetary aggregates, such as M1 and M2. We also monitor other parts of the balance sheet of the banking system. I mentioned several times already the development of credit to the private sector, which continuously since the start of the Euro has shown an annual

increase of 10% or more. Credit to the private sector probably has to a significant extent contributed also to the financing of the wave of mergers and acquisitions which has taken place, both inside Europe and across the Atlantic. That is also a factor we closely monitor. So it is also a whole range of monetary indicators we look at in order to come to a judgement. A judgement literally on what impact they could have on the future rate of inflation.

Chair:

Mr Goebbels, do you want a supplementary question?

Mr Goebbels:

Yes, Madam Chairman.

President Duisenberg has just told me that when looking at inflation, the European Central Bank does not look only at Eurostat statistics but also at advanced indicators. Now, in order to understand and interpret the strategy of the ECB, shouldn't the bank publish these advanced indicators which it uses as a basis for deciding on its monetary policy?

Mr Duisenberg:

What we do publish is the full range of considerations which are lying behind our decisions, whether it is a decision to do nothing or a decision to change. So in that way it is published. If you are specifically thinking of forecasts, what we do look at is forecasts produced by a host of international institutions and private institutions and we have enquiries amongst, I believe, about 80 professional forecasters. We are working hard on producing our own forecasts. But at the same time it is always an analysis followed by a judgement, where forecasts are only one of the inputs in coming to that judgement. We are working very hard on the preparation of the publication of forecasts. We have the first results. Ultimately the forecasts will become public, but we are not yet that far. They are not yet stable enough. To give you one example, we make forecasts based also on econometric models. Ultimately we will also publish the models. But we give them for judgement to colleague Central Banks – national Central Banks that is – in Europe,

and we get the comment that they are not yet good enough to be published. So, we have to work on it further. We are a young institution. Our data span a relatively short time period. So we are working hard on it and, as you know, I am personally one of the great proponents of ultimately publishing forecasts and models. But the people should be educated how to use them : what the limitations are in publishing these forecasts, whose forecasts they are; are they purely technical exercises, or do they come under the political responsibility of the Governing Council? I think they should not be published under the political responsibility of the Governing Council. I think not. The way in which they are used, their degree of stability, and the only relative significance they have has to be made crystal clear to the public, so that the public can handle them in the same responsible way as we do.

Mr Goebbels:

President, you just said that you take some decisions on the basis of indicators which are not good enough to be published. Is it not dangerous to take decisions on indicators which are not good enough to be published?

Mr Duisenberg:

If we did exclusively that you would be right.

Chair:

Mr Duisenberg, I would like to come back to the issue of the inflation rate and growth. Has the European Central Bank a model or an assumption with regard to the how high the growth rate can be in the Euro 11 zone, and does that growth rate govern your decisions? What influence does the American experience have on the assumptions of the European Central Bank? When you say that one of the most important prerequisites to contribute towards employment and growth is price stability in the eyes of the European Central Bank, then should it not be made public how the definition of an inflation-free growth can be linked to which growth rates?

Mr Duisenberg:

I want to emphasise, Madam Chairman, that the American Central Banking law gives a mandate to the federal reserve system which, at least in theory or in legal terms, is much wider, broader, than what is the case in Europe. In Europe we believe that ultimately inflation is a monetary phenomenon. There can be short-term deviations, influences coming from short-term developments in the field of wages, import prices or whatever, but ultimately over the medium-term without money there would be no inflation. You might put it that way. The American mandate is a much wider one. The American bank law mandates the Federal Reserve Bank to contribute to low inflation or price stability, to higher economic growth and to full employment.. This mandate, I might say is so broad and I know that my American colleague fully agrees with me, that there is no way imaginable that the Fed could achieve all the ends included in it simultaneously. So in a way they have to pick and choose. Of course, in fact, the rate of inflation also in the case of the Federal Reserve System plays a very dominant role, but a particular definition of what is acceptable and what is not you will never have seen from the Americans.

Chair:

And from you?

Mr Duisenberg:

From us yes. We have publicly declared and defined that our mandate is to maintain price stability. That is, and we have said that to the Parliament, a rate of increase in the harmonised index of consumer prices of below 2% over the medium-term. So, we could not be more precise than that.

On the growth rate we cannot do anything in the context of our medium-term forward-looking policy, but base ourselves on the trend rate of growth which has been observed for the Euro area over the past 25 years. That is a figure of between 2-2½%. Now, as I said in my introduction, it could be that now we see growth exceeding even 3%, and maybe significantly exceeding 3%, over this year and next year, that that is a sign that there is also a shift in the growth potential of the Euro zone, but it is too early to judge.

We will come to a judgement in December. I cannot forecast or prejudge the outcome of that judgement, which, as soon as it has been made, we will relate to the European Parliament and discuss with the European Parliament, already in December or January. Whenever you call me again.

Chair:

Well, I am sure that we will be hearing from you again.
Mr Huhne has the floor.

Mr Huhne:

Thank you, Madam President.
Mr Duisenberg, there has been some view in the market that your half point increase in interest rates suggests that you may have revised your view of the neutral interest rate for the Euro zone. Could you describe how you assess the neutral interest rate? First of all, in real terms, is the real neutral interest rate in line with your assessment of real growth potential in the Euro zone of 2-2½%? Secondly, what is therefore the neutral nominal interest rate, and perhaps you could discuss how you assess that and, if you could, perhaps give us your estimate?

Mr Duisenberg:

I cannot, because I do not precisely know what the neutral interest rate is. There are many measures there also. What is a neutral interest rate? When you are talking about the role of the neutral rate, and especially the real neutral rate, in monetary policy you are making a judgement about the impact of monetary policy on the real economy, on economic growth, on the development of employment and unemployment. I reiterate that ultimately inflation is a monetary phenomenon, although admittedly in the short-term, monetary policy measures may effect the development of the real economy. Over the medium-term monetary policy has no impact on the real economy. Therefore, firstly, I do not know what the neutral interest rate is nor what its role in monetary policy could be. I believe it is somewhat of a denial that monetary policy mainly addresses itself to the nominal developments and not to the real developments in the economy. Ultimately,

we are strongly convinced that, it sounds like a slogan, but we are deadly serious about it. the best contribution that monetary policy can deliver to the development of the real economy is to create a climate of stable prices over the longer-term, so that inflationary expectations are, if possible, absent, so that decisions can be taken in the expectation that the general price level will remain stable. These are the conditions we are trying to promote and to preserve.

Mr Huhne:

Can I just as a supplementary ask you, have you revised up your view of what the neutral interest rate is? Is that one of the signals you are sending with this half point rise in interest rates?

Mr Duisenberg:

No sir, we have not revised it up because we do not know what the neutral interest rate is. We do not even, not even internally, use or have an agreed estimate of what the neutral interest rate is supposed to be.

Mrs Riis-Jørgensen:

Thank you very much, Chair.

Mr Duisenberg, if we compare the situation in Denmark today where Denmark has a link with ERM2 with a situation where we hope Denmark becomes a member of the EMU, do you think that there are further conditions that Denmark has to fulfil and, in your opinion, would there be additional advantages for Denmark in becoming a member of the EMU? Do you think, Mr Duisenberg, that there would be advantages for the Euro if Denmark votes in favour? In other words, if Denmark becomes a member of the Euro will the Euro as a currency be strengthened? Thank you.

Mr Duisenberg:

Denmark, as a member of ERM II and soon, I regret to say, the only member of ERM II, is performing in such a way that, on a preliminary judgement, it fulfils all the convergence criteria. It could become a member of the euro area tomorrow, so to speak.

Denmark is doing a remarkable job and is a loyal partner in its own interest and in the interest of Europe in the ERM II mechanism. What are the advantages? the advantage for Denmark, - and now I am engaging in a propaganda exercise of course - to be a full member of the euro area is the following : Now Denmark through its economic policy - which it deliberately wants to have - has a stable exchange rate, vis-à-vis the euro, within a margin of 2¼% - but basically, let's face it, the monetary policy of this big area, including Denmark in the context of ERM II, its monetary policy is determined by the ECB and not so much by the national bank of Denmark. The big advantage of being a member is that you co-decide, and your voice is being heard, and you are responsible for the co-decision of the monetary policy stance, which now largely is a policy which one is compelled to follow. It is decided in Frankfurt. The advantage for the euro area of Denmark joining is the same as it is for all participating countries. The euro area is best served, or best serves its own interest, when the common monetary policy applies to as large as possible an area. The euro area now approaches being a market for 300m people, and that is sometimes somewhat under-estimated in the public eye. For most countries, before the introduction of the euro about 75% of their international trade was intra-European trade, and the exchange rate risk was always there and it was always one of the hindrances for the further development of the bilateral and multilateral trade. The absence of any exchange rate risk for the bulk of your "international relations" - and now the European relations in the euro area are really domestic relations - is already providing a significant boost to the development of intra-European trade right at this moment inside the euro area. It is advantageous both for Denmark and for Europe if the area becomes larger, with a country that has demonstrated such a high degree of convergence with the euro area.

Mr Lipietz:

Mr President, this dialogue which has been taking place for about 1½ years, for some of us it seems to be a dialogue of the deaf. You tell us, or your colleagues on the board of the ECB tell us, that the economy is overheating, there is growth, which might lead to inflation, which means that we have to increase interest rates. Yet, you say, not at all. That is not the situation. If you look at a certain large country the inflation rate is very

low compared to the United States, etc. etc. I do not think there is much point in leaving it there. I think we have to try and establish a real dialogue, a real discussion, about growth. From this point of view, your speech, I think, will be analysed very carefully by all commentators, because it sweeps away a certain impression that had prevailed in the economic press for some five or six months, i.e. that your economic policy was fairly restrictive, but that was because of a fear of imported inflation. It is clear from your speech today that your no. 1 fear which keeps emerging is excessive growth compared to balanced growth. This re-affirmation does not surprise us. You and your colleagues told us right through 1999 that for you the balanced growth rate was 2½%. You told us over the last quarter of 1999 that you would not mind exceeding an inflation rate of 2½% if this was due to oil prices, and that is true, the underlying inflation rate here is lower than a year ago, so the real problem is growth. You say so. If you look at the second page of your speech you see that excess growth has become the second pillar which is guiding your monetary policy. So, for you that is the main issue. Could you therefore tell us exactly what in your view is the Central Bank's possible contribution to growth, or rather to a potential growth rate. To achieve that you say one would have to wait until December or January next to see whether one can go higher than 2½%, but what are your criteria for saying 'yes' we can do better?

Mr Duisenberg:

You indicated that my speech will be carefully studied, also by you, and I am highly in favour of that. If you look at the sentence you quote, you read looking at the information provided under the second pillar, "the outlook for growth in the euro area has improved further". It does not say it has deteriorated, that it has become too strong. In no way. On the contrary. I am delighted that we seem to be in for a period in Europe where growth is robust. Growth is well above, and will be well above, the trend rate of growth which we have observed over the past 25 years. We will have growth rates well in excess of 3%. We will have unemployment falling - not by very much admittedly - but that is not the fault of increased growth, but it will be falling. In the year 2002 we expect on current foresight that the average unemployment figure in Europe – I am talking about 2002 – will for the first time in many years start with a 7. It will be below 8%, whereas until

recently we were talking in terms of double-digit figures. We are on the way. Therefore I ask you to indeed study this speech further. We are delighted that we seem to be in for a period of sustainable growth in the future, a period in the course of which we expect to surpass the United States' growth performance some time in the course of 2001. We will do nothing to frustrate that. On the contrary. We will do everything to make it sustainable and to create a climate of stable prices in which investors and consumers can make the right choices without that being distorted by the detrimental effects of too high inflation, which in the end always hits those people most who can least defend themselves against the results of it.

Mr Theonas:

Thank you very much, Madam Chairman.

President, I have a comment to make. Since November of last year we have seen interest rates rise on a constant basis and I think that we have seen five or six interest rate rises on the part of the ECB. This leads to a number of questions. What are we supposed to assume; that ECB policy before November 1999 was not sufficiently considered. Now, we have just heard that growth rates had a negative effect on stability policy. Is that the reason? If we were to have a global assessment today of economic developments then perhaps we should also have a political and monetary assessment, so that members would be better placed to make the proper decisions on unemployment. I think that there is a question mark now with regard to political control of monetary policy in this context.

Mr Duisenberg:

I think, Madam Chairman, you have this opportunity for an assessment every month after you have seen our monthly bulletin in which we give all the considerations for and against moving interest rates or leaving interest rates unchanged. You are in the position to form yourself a well-informed judgement about our policy.

Now, as to the change of heart in the monetary policy stance in the course of 1999. In the beginning of 1999 I want to remind you that we saw the danger- and we shared the thoughts about this with the European Parliament - of recessionary tendencies developing

in Europe. We saw inflation approaching the lower level which we also do not like, namely, zero. In some areas we already thought that if you took account of the measurement bias included in inflation figures, that deflation had already arrived. That led us to decrease interest rates in the course of April last year. In the course of 1999 things changed and the outlook became brighter, but that does not happen overnight. So, to the extent that data became available, that the assessment developed, we ultimately in November decided to reverse our monetary policy stance and with more and more data becoming available, pointing in the same direction, we followed upon that first measure by adopting a more tightening, or, say, a less loose, monetary policy stance. Appropriate, we think, and I hope I can share that with you, for the monetary situation and the economic situation of the time. Take into account a money supply growth month after month, or three months after 3 months, exceeding the reference value, whatever you may think of the reference value, but the excess is very significant and certainly larger than any revision of the reference value which might be undertaken in December. I do not know yet. Add to that credit to the private sector developing at more than 10% on an annual basis It leads us to the conclusion that still today monetary developments are in no way a hindrance for the further development of economic activity in the euro area, and liquidity conditions are still being regarded by the business community, by the public, as being ample and generous.

Mr Della Vedova:

Thank you, Madam President.

Mr President, I think that the most recent policy decisions on interest rates are very good for the Euro economy, not only in combating inflation but also because they stimulate virtuous behaviour and this is what is necessary at a time of growth. There is a structural change going on in the employment market. We want to encourage improvements in public finances. I am thinking of the debt. This encourages a prudential reform which gives you long-term sustainability and if this increases the level of the Euro as it seems to have done, it will improve European companies' competitiveness through investment in technology. So, this brings me to my question. How do you, Mr President, assess the proposal for a political body with real powers in economic policy for the Euro 11? Do

you think that this extra body would be useful and necessary for obtaining European growth based on structural reform, or do you think that this would be a political body which, at the end of the day, would simply increase ambiguity and pressure on the ECB for a policy which is not based on containing inflation, but which is based on stimulating growth? Thank you.

Mr Duisenberg:

The independent policy stance and the independence as such of the ECB is, in my judgement, extremely well-guarded in the Treaty. Any move amongst the European 15 or the Euro 11 to create an institutionalised political body, if it enhances the co-operation and co-ordination amongst Ministers of Finance in fields other than monetary policy, can only be applauded. If it is meant to exert influence on the European Central Bank, it will not succeed. That is, in short, my opinion about it, because, as I say, the position also politically of the European Central Bank is one in which the European Central Bank is fully independent, but also fully accountable to Parliament, Ministers and the public.

Chair:

Thank you very much.
Now we move on to the second part of the first round on monetary policy.
Mrs Villiers.

Mrs Villiers:

Irish inflation, hitting its highest level for 15 years this month, President Duisenberg, has a number of effects, not least of which the unfortunate fact that this most hospitable of nations now has the most expensive pubs and bars in Europe according to the European Commission, leading some trade unions recently to demand an immediate freeze on the price of Guinness. Now, important as this issue is to many of my colleagues, what I want you to address us on is another consequence of this unfortunate fact, and that is the spiralling asset price inflation and the very real inflationary boom in house prices and the prospect of a forthcoming bust. Is there anything that the EU and the ECB can do about

this, given that Ireland is always going to form a relatively small part of the total economy of the Euro zone?

Mr Duisenberg:

There is nothing that the ECB can do about it except from trying to convince the national authorities in Ireland that these developments, which are indeed somewhat worrisome, are to be dealt with by them. Monetary policy as such can do nothing in this respect. I will not deny that our series of interest rate increases will help, but they were not taken with a view to Irish developments only. They are helpful and certainly work in the right direction also for the Irish situation.

Now, the spiralling asset prices. A Central Bank and also the European Central Bank cannot, and will not, form a judgement on what precisely the appropriate level of asset prices is, be it real estate or be it stocks and equity. We do recognise that the rise in asset prices which is occurring here and there, and particularly in Ireland, and also in my country, on the one hand creates wealth effects which may be only temporary. On the other hand, they do carry the danger that the balloon will burst and that might have consequences, although we think as I said in my introduction, that the consequences for the banking system can be overcome. The banking system as a whole is not very vulnerable in these areas, so there is little likelihood that it will spread across the financial system. We are faced here with a dilemma, especially the national authorities. I always say that in the old days before the Euro whenever such a development happened in a country, there was one policeman who very soon reacted and forced a country to take counter measures. That was the balance of payments. When a country competed itself out of the market it was the balance of payments which reacted and showed very quickly a deficit which was unsustainable, and which forced a country to exert a policy of belt-tightening so that these forces could be kept under control. Now, in a sense, Ireland does not have a balance of payments any longer. The euro area as a whole has a balance of payments, so that policeman is on vacation you might say. Ultimately, of course, the same effects of losing competitiveness will work their way through also in relations between Ireland and the rest of Europe. It may take a very long time. We are, indeed,

faced with a dilemma. We see the long-term disadvantages - and I know that the Irish Government sees that also - but here you have a country which has a healthy surplus on the budget, which has no longer a balance of payments, but which does have an inflation rate well in excess of 5%. It is a very difficult situation to handle. On the other hand, I am always struck looking at it historically. Ireland has been a net emigration country for two centuries. Now Ireland is a net immigration country, which is a historical achievement of proportions not to be underestimated.

Mr Tannock:

Madam Chairman, Mr Duisenberg,

The weak Euro has clearly benefited Euroland's exporters recently, although the currency came dangerously close to going into freefall last month as the markets lost confidence in the ability of the socialist governments of France, Germany and Italy, to address the Euro's sclerotic labour market rigidities, and the obvious need for structural reforms, including de-regulation and less red tape. Recently, the Central Bank, under your stewardship, was blamed for the single currency's weakness and calls were made for more political oversight and direction of the bank by the Euro 11. However, is it not the case that you have been unable to give growth a chance by further interest rate cuts, as Euroland's NAIRU is higher than it should be, compared to the U.S.A. with its incredible ten-year unsurpassed record of growth and low unemployment, precisely because of the lack of the political will on this continent for further structural reforms?

Mr Duisenberg:

No, I don't think so. The Central Bank has great powers, but don't over-estimate powers that the Central Bank has. In your analysis, I think if I am permitted to say too, you mentioned some socialist governments: I would also like to point to the socialist government in the Netherlands, which has seen a growth performance - at least the socialists are the largest party there in the coalition – which is not very much below that of the United States, both in terms of rates of growth, in terms of unemployment figures which are now under 3%, in terms of reform of the labour market and all that with a

unified monetary policy. I can say the same for Portugal. I think the generalisation that I just heard was just a little bit too much, and I do think that political interference with the policies of the ECB ought not to occur, as is clear from the Maastricht Treaty. The Maastricht Treaty gives strong guarantees to the Central Monetary Authority that such political interference will not occur. It is even forbidden. I think that works well and it will work well in the future.

Mr Katiforis:
Mr President, Chair,

You have said time and again today that you consider inflation a monetary phenomenon, but, of course, money comes with a velocity and velocities are usually changeable, so one wonders where that leaves your first pillar? But that is by the way.

The main question is, even you will not insist that raising interest rates leads to an acceleration of the rate of growth. We are advised by our experts that the weakness of the Euro is explainable by the persistent growth differential in favour of the United States, which your interest rates rise does not seem to do anything to diminish. If so, and if it is indeed true that the weakness of the Euro is due to a differential growth effect, by your raising of the interest rates you are prolonging, one would say, the weakness of the Euro, the improvement of which has not been spectacular in the markets, lets face it. Therefore, by trying to fight inflation you are exacerbating one of the tendencies to inflation which is the low Euro, you admit. I wonder how you would comment on that.

Mr Duisenberg:
I forget about the velocity point?

Mr Katiforis:
The velocity point is that velocity is changeable and where does that leave your first pillar?

Mr Duisenberg:

Well, it leaves our first pillar where we established it, namely we observed a trend decline in the velocity of circulation of between ½% and 1% per year over 25 years and our indications are that nothing much has changed. We still have, almost to say, an unusually stable demand for money function, more stable than in the Anglo-Saxon countries, on both sides of the ocean. The main thing is the difference in performance on both sides of the Atlantic. They in part explain the exchange rate relationships and the weakening tendency which has been prevalent, and I emphasised fortunately the words "has been prevalent". That growth differential is diminishing but it has not yet disappeared. Still the United States is growing faster than Europe. It will not take long, I hope, before those positions are reversed, but it is still the case, and then it is not the only reason for the persistent weakness. The interest rate differential as such should also be mentioned. Of course it is more attractive to invest in a country where you can make a rate of return which is significantly higher than was the case in Europe. So, interest rate differentials have their effect. They may not have an immediate impact on decisions to change a position, but it cannot be denied that they have an effect. There are more explanations for the development of the exchange rate relationships, also some which I cannot quantify. I have a feeling that confidence and credibility play a role. You cannot forget that the European Central Bank - although the Federal Reserve Bank is not that old, but it is about 100 years old, has been conducting monetary policy for only 1½ years. We still have to build up our track record of credibility and confidence, and that will take time. It may take many years to solidly establish a high degree of confidence and credibility amongst the people at large. I would like to say - we will come to talk about that later - I do feel that one major handicap which we have in communicating with the people at large in Europe, is that they often have the feeling that the Euro still has to come because the notes and the coins are not there yet. I regret that very much, but I cannot do anything about it. The people do not realise that the Euro has already been there for 1½ years, but it is a major handicap in the public perception that they cannot feel the money in their hands yet. It instils a measure of uncertainty amongst the people, which I have to accept, which we have to accept, because we cannot bring the date forward for introducing euro banknotes and coins, but I wish we could.

Chair:

The Parliament shares your view and we asked for that when we prepared for the Madrid summit, but of course the Madrid summit was long ago.

Mr Bullman:

President Duisenberg,

A very brief supplementary to Mr Katiforis' question and then an independent question. You talked about confidence. Are you not afraid that your decision on interest rates will be taken as a measure of lack of confidence in the European economy i.e. that we are not confident in inflation-free growth of between 3.5% and 4%? We are not confident in achieving that, even though wage trends are so moderate. That is the supplementary.

My own question is on the necessity of international cooperation in stabilising the exchange rates. How do you assess quality and the requirements for co-operation between the main central banks. There are very different models which are up for discussion: corridors, sterilised intervention to stabilise exchange rates. What is your personal view on quality requirements and the feasibility of international exchange rate policy?

Mr Duisenberg:

First of all, as far as confidence after our latest interest rate decisions is concerned, Madam Chairman, if there was lack of confidence after our interest rates had been increased, inflationary expectations for the medium-term future and long-term interest rates would have risen dramatically. They did not. That is an indication – and we also read that from commentators in the market – that there is no doubt that our intention to create a climate where a period of economic growth well in excess of 3% can be sustained over a longer period is helpful. We do not have the impression that confidence has been undermined. Rather from anecdotal evidence we conclude that confidence has been strengthened, and I might say, so it should be.

As far as international cooperation to stabilise exchange rates is concerned, also through the use of interventions, the following:

First of all, as I have said repeatedly, I will only comment on interventions ex post facto. I will never do so before they have occurred. The instrument is available. If and when we intervene, I will tell you immediately but not before that. I would like to say that what basically is important is the euro-dollar relationship. I would again and again like to point out the impact of exchange rate variations between the Euro and the dollar. For the euro area, total imports represent close to 15% of GDP; for the United States, it is close to 12% of GDP : relatively comparable figures and second, relatively small. The impact of exchange rate movements on the European economy is significantly smaller than what we in Europe used to perceive. In my country the import ratio was 60%. In Germany it was 30%. Something of that order. Now it is significantly smaller. What people tend to overlook is what I said earlier, that about three-quarters of their foreign trade was intra-European trade, where there is no exchange rate risk any longer – none whatsoever. That is the big advantage of being part of the euro area. Don't over-estimate the impact of exchange rate variations on the real economy. If they are large and persistent they may have an impact on domestic inflation. Then they become relevant also for monetary policy decisions, but still the impact is only limited. And then something one should never forget: we do not have an exchange rate target. We have a mandate to maintain internal price stability. External movements can have an impact on the achievement of that primary objective. We are not neglecting that.

Mr Huhne:

Thank you, Madam President,

Those of us in favour of British participation in the Euro zone, Mr Duisenberg, were very encouraged recently by the OECD country survey, which suggested that the process of convergence was proceeding and that within a couple of years the output gaps in both Britain and the Euro zone would be very similar. I wonder whether you share the view that the UK would be able to have a window of opportunity in which it could join the

Euro within the next couple of years, without the sort of problems which appear to have arisen due to the rather hasty convergence efforts in Ireland.

Mr Duisenberg:

It seems to me that the window of opportunity is becoming increasingly open. It is there but there are certain obstacles to be overcome to my feeling, mainly of a psycho-political nature. The economic conditions in terms of inflation, in terms of budgetary policy, in terms of interest rates, more and more point to the direction that the UK is, let me call it, joining forces with the euro area. The economic conditions are increasingly there. The exchange rate developments are, to my mind, not yet optimal for the United Kingdom to be a full participant at this rate. As long as it is true that the Euro has overshot, certainly the same can be said, but in the other direction also, for sterling.

Chair:

And now we move onto the second round on co-ordination and the role of the European Central Bank in the process of co-ordination of policies, and the role it plays in the macro-economic dialogue, and Mr Radwan is the first speaker in this round.

Mr Radwan:

Mr Duisenberg, at the moment we are in a phase of enlargement eastwards and I have a question on that. With Greece we have our first accession candidate to the Euro area, and here we have talked about public debt in Greece and so on. Now, do you think that we should still be considering these criteria in accession to the Euro zone and the Euro, or do you think that there should be new rules for interpretation and new criteria in some cases. Secondly, for the candidate countries in the Euro area we need a minimum degree of economic convergence. Where do you think that minimum should lie? Thank you.

Mr Duisenberg:

The ECB is not part of the negotiating team with the accession countries, although we do keep a close contact with the European Commission for all issues that are relevant for the ECB and we have reached full agreement with the European Commission to be involved,

or at least in close touch, as soon as we touch upon areas of shared competence or even exclusive competence of the ECB. One of the statements I believe that was formulated in Copenhagen, at the summit in Copenhagen, was that also for the accession countries there should be the willingness to accept the *acquis communautaire* and there can be, and should be, equal treatment for old as well as new members. That implies also that the criteria - if you are talking about convergence criteria, but they are not yet relevant at this point in time – will to our mind have to be respected to the same extent and with no other interpretation than they have been respected for the founding fathers of the euro or for new entrants like Greece yesterday evening. That is as far as the position of the ECB is concerned but, of course, the ECB is not the ultimate decision-maker. Let me put it that way. But then also in this context I think it is wise to again call to mind that I, at least, see the process of accession as a process in three stages: first, there is the accession to the European Union; second, to my mind, some years later there is the step to become a member of the European Exchange Rate Mechanism II, and then maybe again after a few years there is the obligatory step to become a part of the Euro area. Only for that last step do the Maastricht criteria become relevant to form a judgement about the accession to monetary union, just as it has been for Greece in the past three months.

Mr Langen:

We expect a minimum degree of real economic convergence before entry into the Euro. Now, where do you think that minimum should be in order not to endanger the EMU?

Mr Duisenberg:

Well for EMU, as I said we have, whatever you think of them, the convergence criteria in place, but that is years from now. There has to be a much greater degree, to my mind as an economist, of convergence of the real economy of these accession countries, much greater than it is at the present day. That is not even so much in the interest of Europe as it exists today. It is much more in the interest of the accession countries themselves. They are still very much in the process of transforming from a centrally-planned economy into a market-oriented economy. Even with in some areas prolonged transitional arrangements as have been used in the past with new entrants, these young

market economies could not stand the full force of competition in totally liberalised markets and they would be swamped, and it would not be in their own interest to speed up their entry. I know that political impatience is very large, but lets not forget the economic pre-conditions which have to be fulfilled, so that the people in the street also see that they benefit from and do not suffer from participation in the European Union.

Mr Langen:

Well, President, on the macro-economic dialogue, we are talking here not only about co-ordination of financial and economic policies of member states, and a certain amount of consistency with decisions of the ECB, in my view, here we are talking about three levels of discussion. First of all, with the member states; secondly, with institutions like ECOFIN and the European Parliament and thirdly, with our citizens. The European Central Bank is actually independent. Now, how do you assess the view that is always being expressed that the ECB is very reserved and has not got involved in this dialogue to such a great extent or, if so, too late. Now, you can always say that you can justify this later on and, of course, exchange rate changes should not be over-estimated, but what about the discussion on Ireland, of the European Union perhaps stopping the cohesion fund and thereby preventing greater inflation. That would be one thing that could be done, or the issue of massive harmonisation with regard to savings taxation, or an active participation in an information campaign about the reason for the fluctuation and the external value of the Euro. I do not really think that we should necessarily tell our citizens that there are great problems. I do not think there are, but all this affects public confidence, and what view does the European Central Bank take of its role? Should it not be more active in this simply because of its independence?

Mr Duisenberg:

The establishment of a macro-economic dialogue was concluded finally in Köln. We see it as a forum in the preparation of which the ECB has been fully involved. It is a forum for an exchange of views amongst the main economic actors in society, i.e. governments, social partners, and the monetary authorities. A very useful exchange of views is possible, which gives us, the ECB, an opportunity to express our views about what the

others should do, in our opinion, whether they do it or not. It gives the others an opportunity to say what they think we should do, whether we do it or not. Our independence is fully preserved, and even in the Köln statement it is repeatedly underlined that this macro-economic dialogue, I now quote by heart, in no way interferes with or undermines the independent authority of the actors concerned and the ECB is even specifically mentioned, that the independence of the ECB is fully respected. Given all that, we regard the macro-economic dialogue as a useful opportunity for an exchange of views. But one thing is certain, the ECB will never participate or take part in an ex-ante co-ordination of policies. We will not take part in an ex-ante co-ordination of policies, which could jeopardise our primary objective, our mandate, to preserve price stability.

Mr Trentin:

Thank you Madam Chairman.

Mr Duisenberg, there has been a limited increase in inflation. This seems to be mainly because of the price of energy products, and that is determined outside of the Union. It does not seem to be of medium-term effect though, and this could be part of the macro-economic dialogue respecting the independence of the ECB. With a view to a certain cooling, what is the bank's possible assessment of the length of time interest rate increases will last? Some countries have had a lower growth rate. Others have had a higher growth rate than public debt. You have to realise that in some of these countries the recent decisions of the European Central Bank have encouraged national banks to increase interest rates even more, and this is a burden particularly on small and medium companies. It also means an increase in treasury bond revenue which is 5% in Italy, and that means an increased cost for a policy of reducing public debt. Thank you.

Mr Duisenberg:

Yes, of course, Italy, and in particular the Italian budget, has greatly benefited from the decline in interest rates which was associated with the entrance into monetary union because a large part of the Italian debt was financed in a very short-term way. We do not believe that our recent interest rate increases will have the impact of cooling down the

economy. We still think, as I repeatedly have said, that we are busy creating the conditions for a sustained period of economic growth in excess of 3%. What we do believe is that with our interest rate decisions, we safeguard the expectation that over the medium-term inflation will remain below, I must say just below, the ceiling of 2% which we have set for ourselves. Then there is no denying that if interest rates by the Central Banks are increased, that those costs will be passed on to their customers by private banks. But still the interest elasticity of investment has proven to be limited. Then I would like to point out, and I am thinking of Italy, Greece, Spain and Portugal, that we are still talking about levels of interest rates which five years ago were unheard of. Everything I say, with Einstein, is relative and remains relative.

Mr Katiforis:

Thank you, Madam President.

Mr Duisenberg, in this macro-economic dialogue, if indeed that is a part of the macro-economic dialogue, you are going back to the governments time and again recommending that they use any surpluses which are being created right now, from windfall gains like from the sale of those third generation telephone licences, that they use all that to consolidate the budget situation. Now, alternatively that money could be directed to investment and, indeed, to public investment for which we are rather short in Europe. Take, for example, trans-European networks. Now, why this insistence on budget consolidation, and would it not be more correct to take the net position of a country: debts, budget deficit and assets, and increasing assets then would show up favourably and we could have some additional investment which we need now, because we are totally exhausting the excess capacity. Now is the moment to have some additional investment cash, not insist on cutting down budget deficits all the time.

Mr Duisenberg:

It is not for nothing.

Mr Katiforis:

Why not the net position, isn't it the main thing?

Mr Duisenberg:

That's mainly a matter of statistical measurement, the net position, the definition of what is investment, what is consumption. I remember vividly the many discussions I had when I was a Minister of Finance, with my colleague of Education, who always asked : what is a better investment in our future than educating our children better? That is mainly a matter of statistics. That's not that important, but what is important, I think, is, well the following. First of all, whatever you may think of the Stability and Growth Pact, the main thrust behind it and the thinking behind it is the solemn declaration of the participating countries to, over the medium-term, strive for a budget that is either in balance or shows a small surplus. Why? That is in terms of when the economic wind is against you, to create a buffer which allows the automatic stabilisers to work, and it is thought that a 3% buffer is adequate . Then in times when there is an economic downturn, and inevitably at some time in future maybe there will be another economic downturn, however temporary, then we should not be worried that we approach the 3% level. But in order not to be worried we first have to create the situation that structurally we are at an average level of just about balance. Secondly, there are more fundamental reasons for this endeavour. There is still a far too much under-estimated problem of the ageing of the population which inevitably requires savings and investments to be made within a decade from now, which are of a sizeable nature. The awareness is awakening, but in general, to my mind, still very much under-estimated is the enormous impact the ageing of the population will have on public budgets in terms of costs of pensions and health care. That means savings will be necessary for pension funds. Investment will be necessary for health care. In order to be able to do that in a responsible way you have to create the conditions in the budget for that. Another reason why I am somewhat concerned about the present tendency, when there are economic windfalls because of stronger than expected economic growth, to spend or to lower taxes - which in itself I have nothing against, on the contrary - but to do that in the pro-cyclical environment we have now. We are entering a situation where all our economies are performing better than we anticipated and better than the trend they have demonstrated in the past. In this situation then to add an additional pro-cyclical stimulus to that development is rather dangerous.

Mr Schmidt:

Thank you very much, Madam Chairman.

Mr Duisenberg, you just answered a question from Mr Katiforis on the need for structural reforms and you said in your address that in Europe we do need structural reforms, and I would like you to go into a bit more detail and I would like you to tell us which member states in the EU you think are in greatest need of reform. I would like to have a comment from you on the possible role of the ECB in this context, to bring forward these reforms.

My second question is linked to what Mr Radwan said and your view of the applicant countries. Now, if I understood you correctly, you said that if we assume that some of the candidate countries become members in 2004 and 2005, then they will become members of the EMU in about 2009 and 2010. Now, you said that would be compulsory and my question to you is self-evident, because today there is only one country of the 15 that does not have an opt-out which is outside the EMU and that is Sweden. What is your view on Sweden? Can Sweden permanently remain outside EMU? That is my question to you with a view to what you said about the candidate countries. Thank you.

Mr Duisenberg:

Just yesterday evening in Portugal, I witnessed the adoption of the new broad economic guidelines in which specifically country by country recommendations were given for the structural reforms that have to be performed or executed in the individual 15 member states of the European Union. In the context of the Economic and Financial Committee, the ECB co-operated in that context, but we were only one of those who provided an input, but I would like to refer to it. They will have been published by now and I think I can refer to that by now. On accession countries I did not mention the time-frame as you just put in my mouth, but you can infer from it that I would not be inclined to disagree very much from your time-frame. But then I would also like to emphasise that we in the continuous dialogue we have, at least with the Central Banks of the accession countries, emphasised the fact that circumstances in the various countries are very different from

one another. Exchange rate regimes are very different. The state of affairs of the banking industry or the financial industry in the various countries is very different indeed, and therefore I would be very much fearful if all, or a majority, of these countries we are talking about were endeavouring to all come in at the same time. I think one has to allow for the fact that the developments in the countries are very different, that the state of affairs may differ very much and that it is individual judgement which should be applied. Now I am not one of the ultimate decision-makers. I realise that, but that at least would be my advice to those who are ultimately the decision-makers. The accession countries will not have an opt-out clause. They will not have an opt-out clause like Denmark or the United Kingdom and so the process will be irreversible. You will become a member of the European Union first. Then they are expected to become a participant in ERM II. Finally, as the Treaty says, there is the obligation to become a member of monetary union, and to my mind the same holds true for Sweden.

Mr Jonckheer:

Mr President, by reference to the public finances of the Member States and to what you have written in the first paragraph of your speech, I have two questions. Firstly, do you think that there is a correlation in a Member State between the level of the tax burden and macro economic performance? You refer to Denmark in one of your replies, I think in Denmark there is a very high level tax burden but there is also very good economic and structural performance, so I would like you to comment on that question. The second question is this, in one of your replies to Mr Katiforis you said, rightly in my view, that national governments shouldn't start cutting taxes too quickly because the wind might change as you say. However, I see in your text on page 7 that you approve tax reduction initiatives as long as they are consistent with the stability pact. But you don't say anything about reallocation of tax which I think is important. You say nothing about State revenue structures, you say nothing about employment, taxation of labour has increased considerably over the last 15 years. Since in the context of the macro economic dialogue, the European Central Bank expresses public financing opinions concerning the Member States, why don't you at least in your statement today say something about reallocating Member States revenues?

Mr Duisenberg:

Is there a correlation between the tax burden and economic performance? I think there certainly is and alleviating the tax burden, which in some European countries has become rather high should have over the long run, I believe, a high priority. It will increase dynamism in the economies and it will have the effect of no longer, to the same extent, almost distorting the economic performance and it would therefore contribute to better incentives both for workers and for entrepreneurs to start working and to take initiatives. But that is a very general statement. Now on the reason why I am not very specific about how to reduce or to transform tax structures, this has mainly to do with two factors. First of all it is not my area of competence, but sometimes I am not too bothered whether it is in my field of competence. But second, circumstances in the various Member States are very different, so what could be recommended for one country could very well turn out to be very detrimental for another. Of course, in the interest of employment and combating inflation, the ECB would be very much in favour of responsible cuts. I mean cuts in the level of taxation, that would alleviate the tax burden on lower paid jobs and make it easier for companies to hire and pay personnel at the lower end of the scale. In the interest of combating inflation I would be in favour to offset a change in the structure of taxation that leads to price increases, I'm thinking for example of the value added tax, by other measures to contain inflationary pressures. But they may be conflicting ends, I realise that. A general shift from direct to indirect taxation goes against the, also desirable, trend to make indirect taxation contribute to the containment of inflation, but we are often faced with awkward dilemmas in this sense.

Chair:

Thank you, now on to practical questions relating to the introduction of the Euro. These are of great significance to our citizens and here the first question comes from Mr Marinos.

Mr Marinos:

Thank you. President Duisenberg, the euro was created and the ambition is that it should become a strong reserve currency as a counterweight to the over-powerful dollar. Now those who believed in a strong euro invested in it and actually lost some of their capital in doing so. I know in a Financial Times article recently the former president of British Petroleum said that the Americans actually pretend that they actually want to see crude oil prices going down, but in fact they are only pretending because the high oil prices mean that they make a lot of money, oil merchants, oil companies and these are all promoted by American interests. Now if that is true, could we suppose that through the increase in oil prices which plays into the hands of the US, do you think that there is indirectly an attempt to weaken the euro in this way, and isn't there an attempt to stop this becoming a strong currency and a dangerous rival for the dollar, which as far as US interests are concerned would be something they would wish to achieve at all costs? Thank you.

Mr Duisenberg:

I don't believe in such an evil or devilish conspiracy, the internationalisation of the euro is mainly a market driven process, and the Eurosystem will neither foster nor hinder the internationalisation of the euro. We will wait and see. The international use of the euro is no disappointment at all. The euro is by now the second most important currency in the world. Not as important admittedly as the dollar and we don't strive after that, but far more important for example than the Japanese yen. If I may give you some figures, with regard to the international private use of the euro. The use of the euro as a financing currency has been the most significant so far. Euro denominated gross issues of money market instruments, bonds and notes by residents outside the euro area accounted for 28% of total issues denominated in a currency other than that of the geographical area of where the borrower resides. By comparison, in 1998, that same figure then for the ECU was 18%, so that's a growth of 10%-point in the share already in one year. The euro's growth came mainly at the expense of the US dollar, the share of which declined from 58% to 48% between 1998 and 1999. If one focuses on the bond and notes segment of the market, then in 1999 the share of the euro with 33% was only just below the share of the US dollar which was 37%. That is also an indication that the position of the euro is

getting stronger. International issues in euro have been growing consistently over the whole year. In the second half of 1999, in particular, euro denominated bond issues have exceeded those in US dollar both at constant and current prices. Now in the area of the use of the euro, as a medium of exchange, the increase is slower than the use of the euro as a store of value. In particular, it is likely that the share of the euro in trade invoicing is not significantly different from the weight of the euro area in international trade. As far as the use of the euro by Central Banks is concerned, the euro is the second world reserve currency after the US dollar. It is dwarfed admittedly by the use of the dollar for that purpose. According to the latest provisional data, at the end of 1999 the euro accounted for around 13% of official foreign reserve currency holdings of the world. But you have to realise that with the introduction of the euro there were two technical factors which dramatically changed the share of the euro in the world foreign reserves. Firstly, there was the fact that those reserves of participating countries which were held in euro currencies, in legacy currencies like Deutschmarks or French francs, from one day to the other became domestic assets and were no longer foreign assets. The effect of that is equivalent to almost 20 billion euro that in one blow had to be deleted from the foreign exchange reserves figure. What is even more important, on 31 December 1998 the euro system unwound into gold and US dollars, the official ECUs which were issued to EU Central Banks through revolving swaps against the contribution of 20% of their gross gold holdings and US dollar reserves. Then you are talking about a total amount of 61 billion euro. So all in all, the contraction on one day of the total reserves and then consequently of the share of European reserves in the world, amounted to more than 80 billion euros. Now, regarding the use of the euro by other countries in the world and on the use of the euro as an anchor currency, there are some interesting figures. More than 50 countries in the world are currently using the euro in the context of various arrangements as an anchor currency. Out of 87 countries belonging to the so-called European hemisphere, which includes Europe, the Mediterranean and Africa, 35 countries already link their currencies to the euro. In addition, the Rouble is co-moving with the euro much more closely than it did in the past with the Deutschmark. In the Western hemisphere the proportion of countries currently anchoring to the US dollar, that is around 40% of the countries, is similar to the proportion of European hemisphere

countries anchoring to the euro. Now these figures I believe demonstrate that we are on the way up, whether we like it or not, sometimes we don't, because apart from benefits it also sometimes creates obligations. This may especially make my monetary policy experts sometimes somewhat nervous, when they think of the impact on domestic monetary policy which may come from the behaviour of neighbouring countries who are not yet part of the euro area, but have a special relation to the euro. But we still think that can be handled. Things are moving, things are gradual and then, as I believe I have said before in this Parliament, Madam Chairman, around the turn of the previous century, around 1900, the United States was already by far the most important economy in the world, but it took them 60 years to let the dollar become the most important currency in the world. Before that it was sterling. Now I don't say that it will take the euro 60 years to become a significant currency in the world but it may take some time before it reaches its "steady-state" position.

Mr Karas:

We don't have much time and a lot of things have already been said, President, but I would like to add something to what Mr Langen said. The euro's launch and the further stages for the introduction of the euro mean that we need an active political information policy. A very exemplary information policy, and I think that now that we have had this declaration concerning all the technical precautions I don't think the declaration of technical precautions is enough. We've heard a lot about the external value of the euro and other things, but I wonder whether it wouldn't be possible for you yourself to actually ensure that what you told us today could be told by you in all the Member States to the Presidents of the Central Banks. You could draw up with the Presidents of the National Banks the positive balance sheet of the euro and also you could talk about your goals, your communication goals, not just looking at the reaction of the public but also what you demand now of politicians, what you demand of governments, when it comes to their part in this communication and information policy. Thank you.

Mr Duisenberg:

Yes, but with all due respect I believe that we are doing the maximum that we can, and maybe still not enough, to communicate with governments, with counter-parties, with the public, with markets to the maximum extent possible across the euro area and beyond. It was a very deliberate decision to let every first meeting of the Governing Council in the month be followed by a very extended press conference, to put not only the introductory statement of the press conference immediately on the website of the ECB, but a few hours later you find all the questions and answers by about 200 journalists on the website as well. It was a deliberate decision and not required by the Treaty to let every meeting of the Governing Council, the very first meeting be followed within a matter of a week and a half by a monthly bulletin, translated in 11 languages, in which much more elaborated than is possible in the press conference, the decisions taken and the developments in Europe as far as the monetary aspects are concerned are explained. I am almost inclined to say that we are constantly working on that, but I honestly don't know what more we can do.

Mrs Lulling:

Thank you, Mr Duisenberg. Well, that's all well and good what you just said to Mr Marinos in reply about the position of the euro, but those citizens who lost a lot of money because of exaggerated trust or exaggerated expectations as regards the euro in May 1999, well, they have actually lost their trust in the euro I am sure. I think in a lot of circles it is now being considered whether the euro should be introduced as a real currency in coins and notes and perhaps one should backtrack. I know that is out of the question, but some people are thinking about backtracking and that sort of consideration should be met by you, you should comment more on that sort of very negative reaction. As regards the practical aspects of the introduction of the euro, a lot depends on the public acceptance of the euro, acceptance of the euro by citizens, also because of the weakness of the euro vis-à-vis the US dollar that has actually brought down the standard of living in the euro area. It's enough to look at inflation rates. I'd like to ask you, recently I read that there are capital flights out of Europe now and a well known company, Merill Lynch, is saying the euro weakness is the result of huge bureaucracy in the euro area, which is the fault of the socialists who restrict the freedom of people, and

in the future the euro area will be thwarted and stifled by taxes and regulations, what do you think of this? Do you think you need to be less discreet now about those people who are attacking the weakness of the euro? Thank you.

Mr Duisenberg:

Well, the lucky thing about statements by all these investment banks is that they more often than not are contradictory amongst themselves. So I am not commenting on Merrill Lynch or Goldman Sachs or whoever, they can fight amongst themselves. On 5 May, I went to the rather unusual procedure of issuing a statement directed directly to the public at large in Europe telling them that despite all this hype about the depreciation of the euro the average European should not be afraid because we kept inflation under control. He or she should not be afraid that either his or her pension or savings would be undermined, and that was a statement which was intended to appease somewhat the unrest we sensed amongst people all across Europe. I did not have in mind when I made that statement and I got letters afterwards, those people who enjoy a pension in Europe and live in the Bahamas. They have suffered that is true.

Chair:

I have a question on the practical details of the introduction of the euro. The first question concerns the problem of supplying the population with cash; some Member States are providing kits as of mid-December next year. Will that really be enough to ensure that there is a proper supply of cash to the entire population because in the Netherlands I know each household will receive just 8.40 euros? Isn't that much too little? I wonder, would it be necessary alongside coins to make available the small domination notes, the 5 and 10 euro notes. Surely they should also be provided in advance to the population, because otherwise there is a fear that there might well be a collapse of retail, small commerce in January. Another thing that worries us a lot are rumours about the question of conversion fees in the banks, we've heard that only in the first six weeks will there be free conversion, and we've always told the people during the first 6 months there would be free conversion. That was actually laid down in the Treaty. The fact that now everything has to be exchanged by 28 February, might that not lead to a

situation whereby this promise made to the people might actually be relativised? I think that's an important point, and also that we hear from you again about how you are going to provide people on the street with notes and coins, that everyone can be sure that the Treaty norms can be fulfilled. And finally, are you going to offer the banks a retail payments system? I don't think that we've made any progress with the private agreement with the banks.

Mr Duisenberg:

The coins are in the hands of the Ministers of Finance and are their competence. It is a national competence. There is agreement amongst the Ministers of Finance that they should, per country, feel free to give or sell so-called starter kits, for example one coin per denomination to the public at large, but not before the middle of December so as to avoid those coins coming into circulation. Now, I know that some people do not fear these coming into circulation because these first coins will probably be kept as collectors items anyway and it is a small amount. To be very precise, as far as my information goes, it has been decided that this frontloading of coins to the general public in coin starter kits concerns in Austria the equivalent of 200 Austrian Schillings, in Belgium the equivalent of 500 Belgian Francs, in Finland none, in France to my information the equivalent of 100 French Francs, in Germany the equivalent of 20 Deutschmarks, in Ireland none, in Italy none, in Luxembourg the equivalent of 500 Luxembourg Francs, in the Netherlands the equivalent of 25 Dutch Guilders, in Portugal and Spain none. But that is not meant to come into circulation. The motive is to let the people feel the coins and let them become accustomed to them. As far as the notes are concerned, there is agreement among all of us, and now I'm talking about Central Bankers, that one situation which should be avoided is that the notes will be introduced at different periods of time over Europe. That they will be earlier in Germany than in France or vice-versa. They must be introduced all on the same day, and the day we stick to is 1 January 2002. Now there is also agreement that we should prevent notes from coming into circulation amongst the general public before that date. That does not exclude that we want to facilitate the professionals, and now I'm talking about banks, about post offices, about big and small retailers, to have the logistical stocks of notes already in store well before 1

January. I mean, a retail store needs to distribute the logistical stocks over all its branches across the country, whatever country it is. We will make available, or the Central Banks will make available, adequate supplies of notes to all the categories I mentioned as from 1 September 2001, provided there are legal or contractual guarantees that they will keep them for themselves and that they will not be brought into circulation. So they have more than three months to start handling these huge volumes of notes. Now as far as the other practical questions are concerned, we are still discussing and considering who bears the cost of having those notes. Suppose they have them already in huge quantities 3 months before they come into circulation, who bears the costs of having them? A bank has to buy the new notes from the Central Bank, but when will it be debited in the accounts for buying them? Now we are still discussing what we want, which is to make it as cheap as possible and as costless as possible for the retail sector and the banking community. As to the conversion period, well, the costs in this period we want to be minimal. I thought it was agreed to do it free of charge for conversion of 'household' amounts of money into euro. And as to the timing, the Ministers have agreed that the period of dual circulation, that is the period in which old and new notes and coins circulate together, may differ from country to country. It will be limited to a period of between 4 and 8 weeks. That is in practice until the end of February 2002. As a personal note: whether they will be able to achieve that is a different matter. I personally have some doubts. The traditions and techniques are very different in the various countries concerned. The density for example of automatic teller machines, from which you get the money out of the wall, differs from one country to another. You have to give the people running automatic teller machines the opportunity, even by working around the clock, to adjust this large number of machines in time to accept the new notes rather than the old ones. Whether you can manage all that in such a brief period, I have my personal doubts, but we'll see. The intention is to do it within 2 months, That is an agreement amongst the Ministers as far as the coins are concerned and as far as the notes are concerned it is somewhat easier. Now a final question is how long will you be able, if you find an old note in an old sock, to exchange that for a new note? The answer is that it also differs from country to country. In my country, it is 30 years, in some countries it is indefinite, the minimum is 10 years. We will probably have to come up with a common

measure, but then it is only at the National Central Bank that it can be done. So after a period of 2 months it will no longer be possible to convert old notes into new ones at any bank or any grocery store. The Treaty says 6 months at most, but the endeavour is to limit the actual period to 2 months.

Mr Goebbels:

I have a question on another area, the Court of Auditors report on the efficiency of the EMI and the ECB in 1998 and it says that there is to be a special premium for staff to cover an amount of 1.9 million ECU. It turns out that, according to the Court of Auditors, that the services who are responsible for executing this decision have actually spent 2.8 million ECU without asking for the permission of Council. I hope that you have taken the necessary measures so that some of these things will not reoccur, because I cannot imagine that you wanted to set a benchmark for wage moderation because the increase in wages went up to about 38% of the average wage in fact.

Mr Duisenberg:

That last comparison is a bit misleading. I believe, what we did, what the governing council took responsibility for, was that in the transition from the EMI to the ECB to grant to the existing staff who had been working, well, I don't want to use the words I had in mind, but who had been working like hell for more than a year, to make that transition possible to give them a special bonus. The bonus was expressed as a percentage of their salary. It differed from staff member to staff member, and also depending on how long he or she had been in the service of the EMI. Now indeed the costs of that were not, as you have mentioned, 1.9 million ECU but I believe 2.8 million ECU, and it will not happen again.

Mr Gasoliba:

I'll be very brief, I just have a quick question and a comment. First of all, it's a question of all institutions and the ECB wanting to underscore the positive aspects, economic growth, low inflation and interest rates and that is a sort of counterweight to the bad image and the negative image that the public have been receiving recently, where there

were only constant comparisons with the value of the US dollar. Secondly, in your meetings with the National Central Banks and with the Civil Services of the Member States you should ensure that this information campaign for the introduction of the euro is a discussion that is taken down to regional and local level. This discussion is to take place at all levels, so please work with regional authorities and local authorities. With some Member States this is very important, for example in Germany and Spain. I have a third issue I wish to raise. Now, in order to ensure there is more public acceptance of the euro and, as the Chair already said, for our citizens this is a very important subject. I'm talking here about our citizens who travel, there are many tourists for example from third countries who come into the EU, and we have to ensure that these tourists are not completely taken by surprise when they arrive in Europe. So I think we need to think about an international campaign as well, and our citizens when they then travel to third countries they must also be able to see that this new currency is recognised and accepted in third countries. Thank you.

Mr Duisenberg:

We are developing, and it must come underway in a matter of months if not weeks, a huge information campaign. The private contract as you know has been awarded to the Paris based company, Publicis, which was in the news for other reasons earlier this morning. It is a huge campaign, costing about 80 million euro. It will be directed not only at a national level but also at regional levels, country levels, in close co-operation with the National Central Banks, so as to take into account cultural and regional differences which may be prevalent across Europe. The campaign will be conducted in the euro area now including Greece and beyond, so also outside the euro area in non-European monetary union countries. It will also be focused on potential travellers, on the travel industry, on tourists and cash handlers of foreign currencies. So effectively, although of course less intense the further you are away from Europe, but effectively it will cover the world.

Mr Lipietz:

One of the characteristics of liquid currency for the citizen is that he is able to make purchases with it everywhere in the currency area. I think that, until the banks realise that if you write a check and transfer a 100 euros you should be able to buy 100 euros worth of goods in Belgium, until that happens, it will not free up the citizen and the citizen will not accept it. So what do you intend to do to make inter-bank transfers within the EU free, as they are within each Member State? At present it can cost as much as 60 euros for a 100 euro bank transfer.

Mr Duisenberg:

We are fully aware of that problem, it is not in our hands. We have published on 13 September 1999 a press release and a report entitled "Improving Retail Cross Border Payment Services – The Eurosystem's View", and in that report we give seven objectives which have to be fulfilled by the banking industry in order to enhance the use of cross border retail payments. Also, we have demanded from the banking sector that by 1 January 2002 they should have established the proper procedures which make cross border retail payments almost as quick and almost as cheap as domestic payments.
A transfer of money from Bank A in your country to bank B in that country takes about four days. It would be acceptable if you made it from Credit Agricole to the Commerzbank in five days One day extra would be acceptable, but not five weeks as sometimes happens. So we are monitoring it, the European Commission is very active in promoting also a smoother and cheaper application of the retail payments systems cross-border, but ultimately it is in the hands of the private sector, but the pressure and the competition is very large and intense of course, and that is a great help.

Chair:

Unfortunately a lot of our citizens are still paying double fees, which is a scandal. This is also an infringement of the Directive.

Mr Della Vedova:

Briefly, I would like to pick up the last words spoken by President Duisenberg. The success of the euro will be decided by the financial markets, but there's a first transition

which will be the public acceptance and the acceptance by the businesses and companies, and the actual introduction that will affect the success of the euro. Now on this, President, I believe that this perception of the euro will depend on whether citizens and companies will feel they have the right services from their banks, possibly better services than they had in the past. Do you think the European banking system has reached the right level of efficiency and competitiveness, and to wind up, do you think the supervisory authorities for credit, or the central bank as in my country, the supervisory authorities are actually going to develop the credit system? Are they doing enough to help an integrated financial market of a competitive nature to arise in Europe?

Mr Duisenberg:

Well its not up to the supervisory authorities to be active in this field, its up to the competition authorities to be active in this field, and its not up to the central banks either I must say. Like you, I have only evidence of my own experience - I regularly do retail payments in three countries, and in one country it goes better than in the other, and I wish ultimately that in Europe it goes as well as in the best of the three I experience.

Chair:

President, I thank you very much for this very intensive dialogue which we've had this morning. It has been a long dialogue and I think it important that we keep up the regularity of our meetings. We will see whether any of your future monetary decisions draw our attention, but first of all we will in the plenary be drawing up a balance sheet of the first year of the euro. I would close the meeting at this point and give the floor to Mr Garcia Margallo.