Frankfurt E B C

The Euro Goes East

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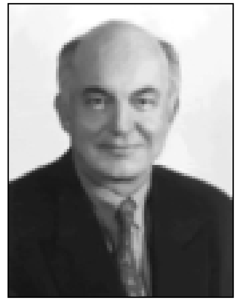
The Euro Goes East



Kemal Derviş

Thank you very much, Ministers, friends, colleagues:

I do have quite a few old friends in the group here and I hope many new ones. And of course it's not easy at this hour, after so much good food and good wine to keep you awake and keep you listening but it is really a wonderful opportunity for me. I just flew in from Washington. At noon today we had the G20 meeting in Ottawa, also the IMFC meeting and the development committee meetings of the IMF and the World Bank and I did have some meetings also today in Washington. And I will try today to start with a few global parts, then share some perspectives on Turkey with you. After all, which is my current hot seat, as Mr. Fahrholz said, it is very hot, I can assure you of that and then maybe close by some remarks trying to link it all together.

I worked in the development business teaching. After first studying and then teaching, I also taught at the Middle East Technical University at Princeton, I was actually a young adviser to now Prime Minister Ecevit who was at that time prime minister for a while and then became leader of the opposition in Turkey . I was very much a committed social democrat, politically, and he was of course leading in Turkey the left-of-centre equivalent of a social democratic party in the seventies. And we worked and I wrote my thesis on planning models and market mechanisms. And I think this was the big topic in the sixties, seventies. In fact, when you look at the twentieth century you could say that in the economics, finance, political economy profession, the whole century was really witness of this big debate about markets and planning, about the state and the private sector, about private property, private initiative and public property. The whole 20th century really was passed with these debates and many people, it was not just debate, of course, it was sadder than that, many people lost their lives in these struggles and in these ideological clashes.
I remember very much as a young student reading Oskar Lange's article “The Computer and the Market”. I can't remember the exact date but I think it was something like 1948 when Oskar Lange, the famous Polish economist, who during

the war had taught at the University of Chicago, said: Look, I was arguing that we needed prices and markets and that we needed decentralised mechanisms even under socialism. But now that the computer has been invented we can do away with markets. The computers can do it all with central planning. And you know, what a mistake, what a huge mistake. And unfortunately, many people did believe in that, for a long time, and many people gave their lives for that.

Anyhow, I think we have arrived at a new synthesis, in the whole world. I believe that everybody has understood that market mechanisms are essential to economic performance and success, that central planning, even with the best intention, cannot replicate the decentralised success of market mechanisms. That even the period when socialism with a human face or market socialism was considered to be kind of an alternative, in other words, you have public property of the means of production but you have markets for commodities. And there was a whole period, as you know, in the sixties and seventies when this was considered an alternative – as a third way between capitalism and socialism. But I think we all realise in the end that you also need a capital market and therefore private ownership of the means of production for markets to actually function. And that markets just for commodities without capital markets would not work. And in the end we did arrive I think at today's situation where free markets, free competition, private initiative are the drivers of economic success, where of course the state has to play a very important role but not as a producer, not as a property owner but as a regulator, as a set of institutions that provide the legal infrastructure and the institutional infrastructure for a market economy to function. And I believe now, whether it is in Frankfurt or Berlin or Paris or Washington or Moscow or Tokyo or Ankara or Brasilia or Mexico City I think this consensus has taken hold. There are decades of course one can discuss about exactly how social security should function, about how the tax rates should be, somewhat higher or lower; these details everybody continues to discuss but I think the basic consensus on what is a good economic system has now been established. It is a system where markets and the private sectors are the drivers of the economy and where the state does not get involved in production but acts as a regulator and, of course, tries to influence income distribution and equity through its expenditures and tax system. It's a huge achievement when you think about what the twentieth century witnessed and what we went through in the twentieth century. But I think it is now a done deal. I don't think that these fundamentals are being questioned any more.

Now does that mean that we are at the end of history, as Fukuyama said? Does that mean that the big ideological struggles are over? That we can all now just concentrate on managing our balance sheet or our tax systems and forget about ideology and forget about grand ideas and struggles? Well, unfortunately, I don't think that is quite the case. And I think the reason why it is not quite the case is because the consensus or the model, if you like, that everybody is more or less buying into has been achieved at the national level but not at the global level. In other words, it is the analysis of the nation state and the interaction of the nation state institutions with the economy, with markets, with the private sector on which there is agreement. Where there is much less agreement is at the global level. And yet, I think, we live in a very global economy, in a very global financial sector, in a very global productive sector. Technology, financial markets, communications, transport costs, everything has made the economy extremely global. I don't think it is reversible. It is true that if you look at the ratio of trade to world gdp, at the end of the 19th century you have had a very high ratio of trade to gdp, then it went down in the twentieth century, particularly during the inter-war period. It reached the level it had reached in the 19th century. In the 80s it is now higher . But it is a different kind of globalisation, much deeper, much more multi-facetted, multi-dimensional than it was in the 19th century. It is not just trade but it's the very way production is organised at the global scale, governance of corporations is organised at the global scale. And, of course, the communications revolution, the new technology makes this into a completely different world. So we have a synthesis, and ideological synthesis at the national level. But increasingly we have a global economy and many of the problems we face in the global system, not just economic problems but also political problems, are of essentially global nature which cannot really be fully solved or addressed at the national level. And in my view, and you know this is, if you like, the idea I want to present tonight as the main idea, is that the decades to come – I should not say the century because a century is such a long period – but certainly the next ten to fifteen years, I think, we will live with a very intense ideological debate about levels of sovereignty, where public policy intervenes with what legitimacy in global affairs, both on the political side and on the economic side. And history is not over, because of that issue of global governance, of the role of the nation state versus global institutions, of the right of the global community, whatever that means; and of course the global community these days, let's face it, very often means the United States of America. With what legitimacy does the global community act? I think these are going to be hotly debated ideological issues which the world will have to deal with. Let me just give some examples which we all know, I mean it's not very original but I think it may be useful to kind of back up my argument of global issues that can only be addressed at the global level.

AIDS is one of these issues. I mean we all know, and when I was working at the World Bank we looked at these numbers very carefully. Twenty, thirty million

Africans, maybe more, will die in the next decade unless there is some very strong action taken on the AIDS issue. Now the paradox is that the treatments are actually available. So it can be done. The resources are not huge, few billion dollars really, five or six billion dollars could do it. But what is lacking is both the governance in Africa, the mechanisms to do it and the global governance to deliver it to Africa. It's a huge problem, thirty million lives at stake but a huge challenge for global governance on how to save these lives. The technology is there, the knowledge is there but the political mechanism, the governance mechanism, the institutional mechanisms are not there.

Another global problem, of course, is environment. You know all the debates about global warming, about the Kyoto protocol and all this. Some progress is being made. It's a global problem. It can only be solved fully at the global level and yet we have great problems generating the mechanisms to deal with it at the global level.

Of course, there is the whole issue of military intervention. We all lived through the Yugoslav tragedy. I was very much involved because, as our Chairman tonight said, I was responsible for Central and Eastern Europe, at that time I was responsible also for ex-Yugoslavia and Bosnia. In the end the global community did intervene. Bosnia, Kosovo, Macedonia, but you know the whole question of the legitimacy of that intervention was very much debated, not clear. And perhaps if it had intervened earlier in a more pro-active way, many lives would have been saved and much resources would have been saved. I mean the Bosnia war, for example, cost the United States alone upward of thirty billion dollars. So, if it could have been prevented a lot of resources would have been saved. Now, of course, September 11th. And when you think about this horrible tragedy you also feel about the negative part of globalisation. I mean, Afghanistan in a sense was left to rot. After the war with Russia was over, people said, „Well, whatever happened in Afghanistan is not really our problem." And so you had a country with no governance or with a terribly extremist group of people taking over, with a mistreatment of women that I think is shocking to anybody who has looked at it. But in a way it was ignored, I mean, it was not considered a problem that we needed to worry about too much. And then came the terrible September 11th event and it shows that unfortunately not only in positive things but also in negative things we live in an interlinked world. We simply cannot let countries or areas fall into the hands of extremists or fall into a situation of no governance because in the end, you know, what link is there between New York and Kandahar? I mean it could be as far as you could possibly think of two worlds and yet a plot hatched there created this horrible tragedy in New York and I think it underlines the fact again that in this century we need global institutions, global controls, global action, global intervention. But these interventions somehow have to be legitimised. They cannot be ad hoc. And I think even in today's struggle against terror, we will face this issue of what mechanisms of legitimacy vis-à-vis the UN or other institutions can really be developed so that these interventions are perceived as legitimate interventions of a governed world rather than just the interventions of a super power on its own.

Now in the financial and economic area I do believe also, perhaps not as dramatic in terms of human lives and so on, but we do the whole issue of financial crisis, of volatility, of excessive volatility of capital flows, of the problems imposed on particular countries by financial crisis. All these things also demand international governance, international roles. The absence of what is in the US law a Chapter XI kind of bankruptcy procedure at the sovereign level, I think, creates massive problems for some countries. And we do need in this area of financial crisis also mechanisms of global governance. I think there is a lot of progress. The work done on the standards and codes under the leadership of the IMF and the World Bank and the support of the G7 and the G20 and so on, I think, is very useful. We must arrive at an economic and financial world also where the kind of governance we have at the national level can also play its positive role at the global level. Otherwise financial crises will happen again and again with great social costs and political costs for the countries that are undergoing them. So I do believe the challenge, you know, Fukuyama is wrong, history is not finished in the sense of big ideological battles. They will not be the ideological battles which we grew up with. They will not be battles between socialism and capitalism, markets and planning, but I think they will be battles of defining governance in a globalised world, of defining legitimate public policy interventions beyond national borders and, of course, this is something where Europe, in a sense, is the leader. Because the creation of Europe, the European project, is very much one of going beyond national borders, creating supranational mechanisms while retaining, of course, and this is important, national identities, national languages, cultures and so on. And so the European project, I think, has significance for all of us, way beyond Europe itself, also for the world as a whole and let me also say here one thought: that I don't think that regional co-operation structures such as Europe are in conflict with globalisation. I think, on the contrary, if Europe succeeds in creating these supranational structures and functions with these supranational structures it will encourage more of that elsewhere in the world. It will not lead to a Huntingtonian world of clashing blocs and civilisations but I think to an increasingly global world and in that sense I don't see regional co-operation and global co-operation as being antithetical or antagonist to one another. I do believe that they will actually be mutually supportive. Particularly as Europe goes East, which is the topic of this conference, and also Turkey is in a very interesting position, of course. It is East and South, Southeast. And we certainly want to be a member of Europe. I know it is much more difficult for Turkey to achieve that than it is for Hungary, or Slovakia, or even Poland which is a large country. But certainly Turkey wants to be a member of Europe. But I think the whole issue of where the frontiers of Europe are is going to be a very active topic. And the governance of Europe. And nobody really knows. I don't think any of us really knows how Europe will be governed five to ten years from now. In a sense, the borders of Europe to the East and to the South are difficult to draw. Yes of course, Hungary and Slovakia will be part of the European Union. What about Serbia? Probably yes. Romania, Bulgaria, yes. But then what about the Ukraine? And of course, Turkey? And what is the relationship between Europe and Russia? I think these are questions which remain open. And I think in some way maybe it is best to leave them open because it will be, I think, through a process of co-operation and globalisation and mutual working together that these solutions will be found somehow. But I do hope that Europe will remain an open construct, not a closed one, and that the European construction and Europe going East will also mean that Europe will contribute to globalisation rather than trying to kind of create a European fortress that in some sense is closed to the South and to the East.

Now let me say a few words on Turkey although the transition is not that easy from these global matters but I think there is a transition. Turkey is a country very much – I don't know how many of you saw the Financial Times of two days ago with Prime Minister Ecevit straddling what seemed like the Bosporus, with his one foot in a city that looked very modern with skyscrapers and you know super-modern area, West so to speak, and his other foot in a city that looked very Middle-Eastern with mosques and everything. And here are these two legs kind of stretched apart, trying to straddle this Bosporus divide. And in a sense that is the challenge for Turkey. But it is also a source of strength because if we really believe in globalisation I think countries which have many links to various parts of the world and which can develop these links very strongly are actually countries maybe which can draw on this as a source of strength rather than weakness. I mean one of the great strengths of the United States – of course toute proportion gardée, I would not want to compare Turkey to the United States – but the United States, you know, is very global in nature. Its tremendous links for example to Latin America and Spanish parts of the US are now virtually Spanish-speaking, it has tremendous links to East Asia, the West coast is linked much more to East Asia than to Europe. Of course it has traditional, very strong links to Europe. It has strong links to the Middle East and to Israel. Very strong links, of course, and it has strong links to Africa through the African-American community. And I always felt that countries with these many links actually in today's global world can use the multi-ethnicity and multi-cultural nature of their societies to be an advantage rather than a disadvantage.

Now quickly to Turkey and the hot seat. You know, I don't want really, it is too late to go into technicalities. But Turkey went through this tremendous economic crisis and in a way it is continuing. But in many ways it is similar to some of the crises we have seen in Asia, it is very similar in my view to the Mexican crisis of 1994 when Mexico tried to manage a more or less fixed exchange rate and ran a very high current account deficit. And I think the collapse of the Lira in February was a terrible shock of course to Turkey. The whole balance sheet of the financial sector got disorganised, the balance sheet of the corporations and – frankly – when I came after this call Mr. Fahrholz mentioned to Turkey I did not quite realise that even individual citizens had borrowed in Deutsche mark or dollars to buy their cars. You know, everybody was having an open position, not just the banks but the corporate sector and the individual citizens. And so the shock of course has been very very difficult to absorb. People had borrowed in foreign exchange and invested in TL and all of a sudden they found that their debts had multiplied in value and I think the getting out of that and getting out of the debt burden that had accumulated in Turkey has been very difficult. But there are three things working in favour of the Turkish programme:

One is: there is a set of very strong structural reforms that have been enacted by parliament and despite of difficulties, coalition politics and all that, 17 major structural reform laws have been passed at record pace and all of them aim at creating the legal and institutional infrastructure for a market economy much less dependent on short-term politics: independent central bank, independent bank regulation agency, an energy sector board regulating the energy market, agricultural policy that no longer intervenes in prices but provides direct support to poor farmers. So a lot of these reforms will make the Turkish system much more robust even against political crises. Because a lot of these agencies will be there and functioning, even if there is a political crisis, the central bank will be there. Nobody can fire – easily at least, I should not say for ever – but to fire the central bank governor is a very tough job now, you know, after the new central bank law. So this is very important.

The second important thing is of course the very tough fiscal policy which we have been able to pursue. The primary surplus this year in the budget is 5.5 % of gdp and we have just agreed with the IMF on a 6.5 % of gdp target for next year but you know the IMF doesn't just look at numbers; they want to see the measures that will lead there and we have agreed on the package of measures that will lead to this fiscal performance. It is tough to be in such a recession and to have such a tough fiscal policy. But I believe quite honestly there is no other way. When you have such a high debt burden you must use fiscal policy to reduce the debt. Now I wish Argentina well, I wish Carvalho well. I don't want to be with him all the time on the same page in the newspapers but it is true that, you know, unfortunately, the way the tax system works in Argentina is, they have failed to perform on their fiscal performance targets in their economic programme almost every month this year. In the Turkish case, Turkey actually met the fiscal performance targets of the IMF programme at every review throughout the year. I think it's a big big difference to have this kind of successful fiscal policy versus being unable to produce the fiscal results that are promised under a programme and I think, frankly, despite all my arguments and sometimes rather nasty arguments with some of my politician friends I must admit that in the end they delivered and we have, we are running this successful fiscal policy in Turkey, and it is very very important. I should also say, there is a view that well, with September 11th, Turkey is now strategically more important, you know, Turkey is going to send some troops to Afghanistan, Turkey will be part of the steering group for the economic reconstruction of Afghanistan. Of course, all these things help, I am not saying they don't help. And I think countries such as the US, or Germany, or France, UK are of course happy about this and are, I think, giving increasing importance to the alliance with Turkey and to Turkey's role. But I also believe, quite sincerely, that if Turkey had not performed on fiscal policy, had not been able to fulfil the IMF performance criteria, the kind of new programme which the IMF board in principle agreed to support last week, you know, the new financing, would not have been possible. I do not believe that these things happen in the international financial community just for political leverage. It helps, it makes it happen more quickly. And on the margin, it provides perhaps a little more resources. But I do believe that the fundamental reason we are getting this support and that the IMF is in fact extending such support to Turkey is because we are delivering on fiscal policy. If we were not delivering on fiscal policy, I think, the situation would be different.

And finally, the last point on Turkey is the exchange-rate shock and the devaluation in the past, in February, March. It created a big problem, but right now we have a very competitive exchange rate. Export growth in the first eight months of this year in dollar value is 14 %. October exports, despite September 11th, were up 26 % over last year, in dollar value, and I think it shows that a very competitive exchange rate with a diversified economy like Turkey will not depend on the big commodity export, you know it's a very diversified kind of export, leads to good export performance, although it is hard, given the world economy's slow growth. You know, the overall growth of trade is 1.5 %. So to be able to have an export growth of 14 % in a world economy growing only at 1.5 %, I think, is pretty good performance. Tourism is our big worry because people are really afraid to travel and we don't know how the tourism sector will do next year. But on the export side we are doing very well. So structural reform, strong fiscal policy, good export performance, I think, will get Turkey out of this crisis and I believe that even if there are political squabbles, and coalition changes and ministerial disagreements and things of that sort, I sometimes think of a country that I like very much and I admire very much, which is Italy, which had a lot of coalitions, a lot of political crises, a lot of ministers changing, but in the end, because the basic governance of the economy was good, and the private sector was dynamic, I think Italy did very well and is now one of the most prosperous countries in the world. In a sense, I feel, that Turkey will be a little bit like that. I don't foresee a political miracle, I don't foresee all of a sudden great political stability in Turkey. We will have political problems, crises, changes, and I do believe with the structural reforms we have passed through parliament, the basic institutional and legal infrastructure is in place for a much better economic performance.

And we do want to include the Southeast into the East. We do probably not as quickly as some of the Eastern European countries but we do want to be part of Europe. We are in many ways already part of Europe. As you know, Turkey joined the Common Market with zero tariff protection for industrial goods as early as '96, ahead of many of the Eastern European countries. And I think if we succeed with our legal reforms, constitutional reforms and the economic programme we will have a chance to make it into Europe, perhaps faster than people think. And I think it is going to be good for Europe, because it is an opening, it is Europe, yes, as a region, as a culture, as a co-operative group of nations, but a group of nations that is open, that contributes to globalisation, that is not closed, and I do believe Turkey can provide this bridge but will make also Europe, I think, stronger with Turkey than without Turkey.

Many thanks. I think it was too long after so much wine and good food but I really enjoyed being here. Many thanks.

The Euro Goes East

Petra Roth

Thank you very much for attending this Congress.

And as you may know, Ladies and Gentlemen, in 38 days the euro will be in everybody's hand and we will witness an exciting highlight of European integration. The realisation of the European Monetary Union, now with 12 members, is really one of the greatest moments in European history. Despite the fact that a large part of Europe's financial system has already worked with the euro since 1999, for most of the European citizens the euro is only arriving now. The psychological importance of having euro banknotes and coins in one's pocket should not be underestimated. With this the euro can finally fully develop its strength as an instrument as well as a symbol of integration.

We all know that the European Union will face enormous challenges in the years to come. The EU is still rather more an association of 15 members than a really integrated union. Enlargement and internal reforms are on the agenda and it has to be a parallel process. Enlargement without reorganisation of the EU's internal structures will not work, just as internal reforms without enlargement will not happen. I think personally everybody agrees that Europe has to be more integrated in order to be strong enough to succeed in a globalised world. The European Union's outward strength requires an equivalent of inward strength. We need a strong Europe which is capable of handling the problems of the community and its people successfully.

The enlargement process started with the Luxembourg summit in 1997 and got strong impulses from the summits of Nice in 2000 and Göteborg in 2001. In the meantime, the EU has accepted ten transition economies as full candidates for accession. The accession of these ten nations would increase the population of the EU region by more than one quarter and the surface area by about a third. But this is not the whole story. We know that, along with the enlargement, the economic disparities within the Union will increase dramatically and great efforts by everyone involved are necessary to achieve successful integration. The toughest issues will be agriculture, structural aid and labour mobility. And as soon as they fulfil the convergence criteria the new members also will be candidates for membership in the European Monetary Union.

This complex field of the different aspects of integration and enlargement – I think – will be the subjects of discussion in the three panels following afterwards.

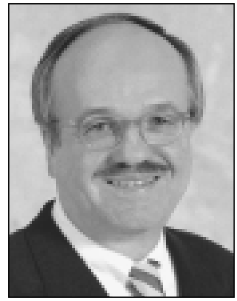
Ladies and Gentlemen,
I would like to express my gratitude to those who have made this congress possible, especially to you, Mr. Fahrholz, chairman of this year's Frankfurt European Banking Congress. I would like to express also my special thanks to the panellists – distinguished personalities from commerce and politics – contributing their expertise to the debate.

I wish you a successful congress, interesting talks and by the way, I hope you will have a pleasant stay in our city.

A very warm welcome.

The Euro Goes East
Conference Introduction

Bernd Fahrholz



Madam Mayor,
Excellencies,
Ladies and Gentlemen,

It is a great honor and pleasure for me to welcome you, also on behalf of my colleagues from Deutsche Bank and Commerzbank, to this year's European Banking Congress. Given the difficult situation we have been facing since September 11, I would like to say a special word of thanks to all of you for having chosen to come to Frankfurt and help continue the good tradition of this conference.

September 11 has confirmed something we knew: the world has become highly interdependent. It has also confirmed something we did not know: our world has become highly vulnerable. Thus, the dark side of globalization is vulnerability!

The introduction of the euro and the perspective of EU eastward enlargement are historic events. They have been overshadowed by the terrorist attacks and the synchronous recession on both sides of the Atlantic. But the euro-agenda has not become less important. September 11 starkly pointed out that the world will not wait for us Europeans to get our act together. If we understand this, there is one more reason to push forward our agenda right now.

The impact of September 11 on the global economy has been to bring us close to a global recession. We seem to be moving toward a world in which the economy is globalized, but in which economic policy remains largely bound in national terms. In this new world, there are limits to the effectiveness of national economic policy.

Seen in this light, the European agenda becomes more important and more urgent. It seems to me, for example, that an institution such as the European Central Bank was well placed to handle – in cooperation with the U.S. Fed – the threat to the stability of the global financial system in the aftermath of September 11.

With 376 million people and an aggregate gross domestic product of 80 % of the U.S. level, the present EU-15 has become a heavyweight in the world economy. The community's expansion towards the east and southeast will increase its total population by another 28 % and its GDP by 5 %. However, the political weight of a union with 480 million people will be much more important than these figures can display, not least in terms of stability and security in Europe.

There seems to be broad consensus that neither an expanded European single market nor a bigger monetary area necessarily require political unity under the roof of one central EU government. However, in order to bring its political weight to bear, the community must "speak with one voice" as much as possible. This in turn presupposes that the EU institutions work as efficiently as possible.

Earlier rounds of enlargement comprised a maximum of 3 candidates, whose economic standards and structures were not too far away from the respective EC or EU average. Today, the situation is completely different. In a Union of 27 members, the gap between percapita incomes will climb to over 20:1, from 3:1 today. Against this background, it must be permissible to ask whether everything has been done to ensure that there will be no disruptions in a 27-member Union. Europe will be able to "speak with one voice" vis-à-vis third parties only if it is able to reach internal consensus on important political and economic issues in a sensible way.

The Community's institutions, policy schemes and financial mechanisms as they exist today were originally conceived for a group of six, not for fifteen, let alone twenty-seven. The European Council of Nice made clear that the problem has been acknowledged. Even more importantly, the EU has initiated changes, moving fundamentally in the right direction. Measured by the concrete outcome, however, the perspective is still not very encouraging.

If enlargement is to be successful, it must be well prepared both by the candidate countries and by the European Union. And both still have a lot of work to do. The statics of EU institutions must withstand the dynamics of growth. I am not convinced this will be the case. It is particularly alarming that in key political areas such as tax and social security policy, the principle of unanimity has not yet been abandoned. Decisions on structural and regional assistance are also still subject to unanimity. As a consequence, net recipient countries – and that means all new members – would be in a position to block any reduction in funds. This could impose serious additional burdens on the EU budget.

It must be in the interest of all EU members that the Community remains politically maneuverable. Decision processes in the EU Council must be as simple as possible and the EU Commission as lean as possible. It is unlikely that a 27-member commission would be capable of working efficiently.

Turning to the financial mechanisms of the Community, a major overhaul is necessary here as well. EU enlargement will not only widen the general income gap but also the structural differences in Europe. In the candidate countries the relative importance of agriculture is three times as high on average than in the present member states. Pent-up demand for transport and environmental infrastructure is high. This will inevitably exert pressure on the EU budget, so we cannot bury our heads in the sand and continue business as usual.

If the financial mechanisms were not adapted, the EU would face additional costs of some € 44 billion annually by the middle of the current decade, according to our economists' estimates. Germany's net contribution, for example, would double to more than € 20 billion – an additional burden that would be extremely difficult to convey to the German tax payer.

In this context, one can hear justifying voices pointing to the benefits that Germany, as the largest economy in the EU, draws from integration. Economically this is sheer nonsense, if you will pardon my saying so. It is a matter of fact, underpinned by economic theory, that open markets, higher trade intensity and greater division of labor leave all parties involved better off. And it is fair to expect that the new EU member countries will profit in an above-average manner from the adaptation of production, investment and employment in the expanded community. It contradicts basic economic reasoning that A pays for the advantages that B draws from international markets.

Nor should we disregard the political significance of the problem. Integration is a process, not an administrative act. European integration will only work if EU institutions and the political decision processes find broad acceptance. It would be fatal if citizens associated the EU primarily with large-scale redistribution of income. "Social cohesion and solidarity among Member States" as claimed by the EU Treaty must not be forced upon Europeans. It needs to grow. The low turnout at the elections to the European Parliament – EU-wide less than 50 % on average in 1999 and in 5 countries even less than 40 % – is a clear message.

Don't get me wrong! Transfers will continue to play their role in the EU. But they must be fair, must not hamper the necessary structural reforms and should help the new members to help themselves.

Another point that seems important to me: a wider Europe must counter centralist tendencies early on. In designing the future Union and in order to give full credit to the historic import of this enlarged round we must take into account that our new EU partners have had their very particular experiences with centralism. Globalization calls for less bureaucracy, less direct political interference in market processes, more decentralization and strict compliance with the principle of subsidiarity. This principle is not enshrined in the Maastricht Treaty for nothing. Its observance is imperative now and will be imperative tomorrow.

Accordingly, public services should be provided and financed (!) at the lowest possible level – municipality, regional government, central government, European Union – depending on who benefits. The application of the subsidiarity principle is not only recommendable for reasons of economic efficiency. It also keeps political decisions close to the citizens.

Ladies and Gentlemen,

The title of this year's European Banking Congress is "The Euro goes East" – a caption which hints at the scope and depth of the project which lies ahead. The future new members of the European Union will inevitably, sooner or later, become members of the European Monetary Union as well. They cannot opt out of the euro. Mr. Duisenberg will certainly give us an insight into the preconditions for the ECB to support the euro's going east.

The first panel this morning – "Europe Goes East" – will deal with the political aspects of the European enlargement and integration process. As finance can also be a highly political issue, we might hear from Mr. Verheugen whether we are going to fund it out of regular budgets, or whether the tax payer must expect another "solidarity surcharge". This afternoon we will have with us Mr. Schüssel, the Federal Chancellor of Austria; his country has traditionally played a key role in east-west relations, so it will be interesting to hear Mr. Schüssel's view of the future shape of Europe.

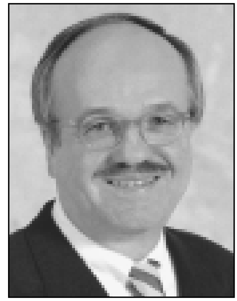
The other big themes of our Congress are "Banking on Eastern Europe" and, in the afternoon, "The Euro Goes East". We are extremely pleased to have with us on all the panels eminent experts who can speak with authority and intimate knowledge on the various subjects.

Ladies and Gentlemen,

Eastward and southeastward enlargement of the European Union is an absolute must! But we must not make a hazardous venture out of it. Enlargement must be well prepared and well executed, with proficiency. And – most importantly – we must talk honestly with each other. Again, the project must be well prepared – not only in the candidate countries but also in the West, in Brussels!

Europe Goes East
Opening Remarks

Bernd Fahrholz



Excellencies,
Ladies and Gentlemen,

It is a great pleasure for me to be chairman of panel number one. “Europe goes East”, the title alone already conveys movement and activity. And I am convinced that this will not stay a hollow promise, as the composition of the panel seems to guarantee a very active and animated next hour and a half. We invited representatives of EU member states, of candidate countries and of the European Union itself, and have thus gathered a broad spectrum of political perspectives around one conference table.

I am very pleased to present a panel of individuals who are deeply involved in the EU-enlargement process.

There is Anna Lindh, the minister for foreign affairs of Sweden, a comparatively young EU-member state. The country joined the Union during the last enlargement phase in 1995. It might have been for this reason that Sweden, during its presidency of the Council of the European Union in the first half of this year, strongly prioritized the progress of enlargement. Anna Lindh – one of the driving forces of this process – has nevertheless always taken a very pragmatic point of view towards the EU. So she once said in an interview with a German newspaper: “You can be European and at the same time be critical.” Hoping for some very constructive criticism today, I would like to welcome Ms. Anna Lindh.

Our second panelist is Siim Kallas, the minister of finance of the Republic of Estonia. Representing one of the candidate countries, he is in the rather comfortable position that Estonia very often is referred to as one of the star pupils of the transformation and integration process. It is seen as one of the front-runners to join the Union. There are even some economists who propose that the country should introduce the euro unilaterally today because the Estonian Crown has already proved its stability in a currency board. I am eagerly looking forward to Mr. Kallas´ estimation of the enlargement process. Will it be a walkover for Estonia? Welcome, Mr. Kallas.

It is also a great pleasure to welcome the minister of public finance of Romania, Mihai Nicolae Tănăsescu. Despite all the efforts and also remarkable successes of the last 10 years, the country still has to undergo profound and partially also painful structural changes before it will be ready to become a member of the European Union. Most experts do not expect accession before 2008. A man who has been accompanying his country through all the ups and downs of the ongoing transformation process is Mr. Tănăsescu. I am very glad that you could join us today and await with great interest your reflections on "Europe going East".

Our panel is completed by Günter Verheugen, member of the European Commission and in charge of enlargement questions since 1999. In this position he is confronted with a lot of questions concerning the accession of the central and east European candidate countries. In a recent study, our economists highlighted the fact that, without reforms, enlargement would prove very costly. In the political camp as well there is evidently cross-party agreement that reforms are essential – I recall the recent statements by Federal President Rau and Messrs. Stoiber and Clement. What reforms can we expect, Mr. Verheugen?

At least, Mr. Verheugen, you might feel comfortable in the middle of our panel today, as all panelists themselves may be regarded as advocates of the enlargement process. But I cannot guarantee for the audience (and some of my economists). Welcome, Mr. Verheugen.

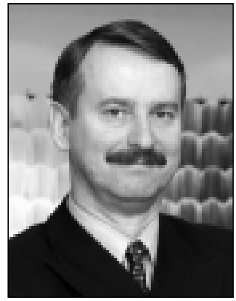
Ladies and Gentlemen,

Mr. Schüssel, the chancellor of the Federal Republic of Austria, who was announced as being one of our panelists in your invitations, unfortunately cannot join us this morning. But you will have the opportunity to listen to his keynote address this afternoon – one more incentive to stay with us during the whole conference.

Ladies and Gentlemen,

as I have already had my chance to present – at least – some of my thoughts on the subject of this conference in my introductory speech, I will now leave the floor to the panelists.

Europe Goes East



Siim Kallas

“Europe goes East" – also the recently presented European Commission’s Regular Report confirms the fact. It basically opens up for the expansion of the EU to the Central and Eastern European Countries in the coming years. Europe will go east and what it will find is Europe. Allow me to introduce you to one part of this Europe – Estonia, and how it is ready to meet the other side of Europe.

Estonia is considered to be one of the most advanced transition economies in Central and Eastern Europe. It is known for its radical reforms. Indeed, we made many bold and fortunate decisions at the beginning of the 90’s and those decisions have also been followed determinedly. As a result, these substantial reforms that emphasised price liberalisation, rapid privatisation and a liberal trade regime, brought about an early macroeconomic stabilisation and the creation of a favourable environment for economic development. The economic growth was around 6% in the period 1995-1998, peaking at 10.4% in 1997. The economic growth is expected to be about 5% this year and 4% for the next year. Inflation is currently running at 5-6%. An important component in our economy has been the high level of investments (over 25% of GDP). This is closely connected to the successful privatisation process, which is now already finished. Estonia has one of the highest accumulated FDI levels per capita in Central and Eastern Europe.

All the candidate countries have for 6-7 years intensively prepared for the EU membership and with the message from the report the finish line has come to our sight. Estonia, among others, has actively pursued EU membership. Most of the legal system has been harmonised and continuing efforts will be made to strengthen the implementation record. The Estonian economy is very tightly linked to the EU. Some 70% of trade is with the EU and 85% of the FDI originates from the EU. Being a small and open economy, the possible EU membership will further help to withstand the global economic fluctuations. But the membership will bring some other non-economic benefits as well. We will enjoy a better quality of environment, safer workplaces etc. We are coming as equal partners. The high share of the EU trade and openness of the economy has confirmed our ability to cope with market pressures.

The banking sector has strengthened significantly, supported by consolidations since the end of the credit boom in 1996-97. The process of consolidation has been accompanied by a sharp rise in foreign involvement in the sector, which has helped to improve the banks' financial, technical and managerial capabilities. The whole sector is now in private hands. And all three largest banks in Estonia are now all majority-owned by Scandinavian investors. Both assets and liabilities are better structured than in 1997, and corporate governance among borrowers has improved. Estonia recently became a member of the Norex stock exchange alliance, which will lead to increased additional portfolio equity flows.

There will be no big question as to why Estonia wants to be a part of Europe. I will use this opportunity to raise the reverse question – why should Europe need us? Openness and prudent economic policies have been the keywords in our success. Being a small country, being characterized by flexibility and dynamics is our advantage over the bigger countries. Truly, foreign economic relations have served as an engine for the development of Estonia's small and open economy. Economic growth has, to a great extent, been based on the rapid growth of exports. This has been supported by liberal trade policies and there are no constraints on current account transactions. The fast development of Estonia is based also on the investor friendly tax policy, very conservative loan policy and the stable currency, as well as on innovative and well-educated people. By joining the European Union, we are not losing these advantages.

As a proof of the prudent policies and a strong underlying economic structure, Fitch IBCA upgraded Estonia's credit rating to A-, which means we belong to the top club of Central and Eastern European Countries in terms of ratings.

Economic freedom in Estonia has been highly valued internationally. According to the Heritage Foundation Economic Freedom Index for the year 2002, Estonia ranks 4th together with the United States, Luxembourg, Ireland and Netherlands, among 155 countries.

According to Transparency International's annual Corruption Perceptions Index, Estonia is the least corrupt country in East and Central Europe.

To achieve this and to become a viable actor on the EU market, Estonia needs to complete its transition process and further improve the functioning of a modern market economy. To reach the main policy objectives, economic policy will be guided by the following principles:

- Maintaining the currency board arrangement;
- Achieving a balanced government sector budget in the medium term and maintaining the conservative borrowing activities of the government sector;
- Maintaining a liberal trade policy and ensuring a favorable investment climate.

The main objective of the economic policy will be the creation of a stable and business-friendly environment and the enhancement of the competitiveness and productive capacity of Estonia.
This will be achieved by:

- further developing the business environment – through further developing the infrastructure to support entrepreneurship, promoting cooperation between companies and developing new management structures. The need to pay attention to the latter factors arises from the changes in the world economic environment caused by globalisation and Information and Communication Technology development;
- promoting investment – through increasing the volume of potential investment resources and improving access thereto, as well as increasing the variety of financing instruments;
- promoting innovation – in addition to human resource development investments in knowledge and support to new branches of economy are crucial for advancing the competitiveness of the state;
- fostering internationalisation – through promoting exports and foreign investments.

These policies and continuous innovation should make us well positioned for a new takeoff of stable and sustainable economic growth and keep us near the front of the race for EU accession.

Even though the environmental aspects do not encourage Estonia to be a very attractive country for running telecommunication businesses, Estonia has been able to do so efficiently and profitably. A small population (only 1.4 million inhabitants) and a relatively low disposable income (4400 EUR per head of GDP this year) are making the operation of telecommunications networks and providing telecommunications services rather difficult. However, Estonia also has several environmental advantages. Estonians are eager to use any kind of communication services and facilities available. Throughout the last decade, the communications sector has contributed constantly more than 5% of annual GDP – in Scandinavian countries the respective contributions are only half of this. Estonia has the highest percent-age (1%) of the ADSL connections in Europe (Sweden 0.78, Germany 0.77%, Finland 0.48%).

The first mobile network in Estonia was launched in 1991. Currently, there are three GSM900/1800 operators in Estonia whereas the mobile penetration reached exceptional 52% (among the CEE countries) by October 2001. The mobile industry has also rapidly developed vertically into a value chain – a lot of mobile content services and applications have been introduced. Mobile parking, mobile positioning, mobile internet and data, incl. WAP and SMS services, e-commerce, entertainment and information services are available via mobile terminals.

The Internet has been one of the most popular communications services over the last ten years. According to the last RIPE (Reseaux IP Europeens) record, Estonia holds the 15th place in Europe in terms of people per internet host (28 people/host). A wide range of IP based content and application services are available in the country – a variety of commercial, information and public services, including internet banking (23% of the population are using internet banking), e-commerce (penetration 6%), entertainment and information portals, e-Tax Department, and e-Government to name but a few. Last year, the IT College opened its doors.

In this field, it has been a close cooperation between the public and private sector. In association with the state, a new foundation "Look at the World" (more than 31 million DM will be invested during 3 years) was established by the 10 biggest Estonian companies (banks, telecommunication and IT companies) in July this year. The purpose of this extensive project is to increase the number of internet users and through this to raise the living standard of the people and Estonian competitiveness in Europe. The main objectives are also to have free internet access for everyone by the year 2004 and, by that time, to bring the number of internet users to the level of that of Finland, which has the highest degree of internet users in three years. 36% of the Estonian population now has internet access (Finland 50%). Already this year, 200 free internet centers will be created.

The above-mentioned indicates that Estonia has a good position to be an equal partner as well as a fair competitor to other European countries. We do not come to Europe empty-handed. We intend to take part in creating a more efficient, flexible and forward-looking European Union. It is our common project, with benefits for both sides.

Europe Goes East

Anna Lindh

Ladies and Gentlemen,

I am very pleased to be here and pleased to be in Frankfurt again. I had a bit of a bumpy flight from Sweden this morning, so I came to think of a Bob Dylan song, that could also be a metaphor for the candidate countries on their way to membership:

> "…landed in Brussels on a plane ride so bumpy that I almost cried,
> clergymen in uniforms and young girls pulling muscles
> - everyone was there to greet me when I stepped inside"

The candidate countries, on that bumpy road, why are they so eager to get inside? Because they have seen how European integration has ended conflicts and wars, how it has brought peace and prosperity, how it has taught large and small countries to live and work together. The enlargement of the European Union is nothing more, and nothing less, than the final historic step in this integration.

Enlargement will also add strength to our economy. The addition of more than 100 million people, in rapidly growing economies, to the EU's market of 370 million, will boost economic growth and investments and create jobs in both old and new Member States. Enlargement might be the necessary economic stimulus need in the coming years, when we frighten a downturn in the economy.

Enlargement will add political weight to the Union. Enlargement will add cultural richness and diversity. Through enlargement, the European Union will not become less European, it will become more European.

We now need to build on the momentum from the Summit in Göteborg, which agreed that negotiations should be finalised by the end of 2002, for the next accession to take place in 2004, and explain the benefits of a united Europe to our citizens.

I look forward to welcoming the first new members in 2004! But we must not forget the principle of differentiation: each candidate country must be assessed on its own merits. No one can be allowed to slow down another. If ten countries are ready in 2004 –so much the better. If not, those that are ready should join. The worst we could do is to let them down, after all their efforts, and to not keep to the timetable, to not welcome them in time. I don’t dare to think about the reactions among the citizens in Eastern Europe. As politicians, we have the responsibility to fully explain the benefits of a united Europe to our citizens,

Simultaneously with enlargement, the EU is developing its relations with all its neighbouring countries, not to create new borders in Europe.

The Common European Economic Space, conceived during the Swedish Presidency, will link Russia economically to the Union. Together with a free trade area around the Mediterranean, and developed relations with the Ukraine, we could, in a few years time, have a market of nearly one billion people trading freely with each other.

The single most spectacular event in the near future is, of course, the introduction of the euro coins and bills. I am convinced that this last stage of the Economic and Monetary Union will be a success. That is as important for Sweden as for the twelve countries participating from the start.

Personally, I hope that it will pave the way for a positive outcome of the future Swedish referendum on the euro. For my own part, I am convinced that Sweden should join the monetary union because:

- it makes economic sense: it reduces costs, increases trade and provides shelter in times of crisis.

- it makes political sense: it is an integral part of the Union, where we want to play our full part.

- it makes democratic sense: it is decisive also for our monetary and exchange rate policies, so we should participate where decisions are taken.

After enlargement, the Union will carry even greater weight in the world. And our responsibilities and possibilities will grow.

We have both responsibilities and possibilities in foreign policy – a foreign policy built on our values – democracy, human rights, solidarity.

Had the EU had a common foreign policy ten years ago, we could have avoided a decade of war in the Balkans. Today's global challenges are numerous. We are now discussing how to deal with anti-globalisation. But the EU needs a strategy for globalisation much more than it needs a strategy for anti-globalisation.

In many ways, we are much better off than ten years ago: we are developing military and civilian capacities for crisis management; we are more active and influential in the Balkans, in the Middle East, in Africa. And in the world after September 11, the EU, when acting as one, is effective and influential. But we should do much more:

- We should strengthen our military capacity for crisis management by setting up, as President Chirac has proposed, a Rapid Reaction Force which, on behalf of the UN, could cover the critical early phase of a peace operation, before a regular UN-led peace keeping force could be deployed. And the EU should offer military capacity also for the UN's regular peace keeping.

- We should strengthen our civilian capacity for tasks like police, demining and small arms destruction.

- We should prevent violent conflicts by using our many political, diplomatic, military and economic instruments, as we have done in Macedonia. We might need to develop a conflict prevention strategy for Central Asia, in close co-operation with the countries and with international organisations.

- We should further increase co-operation with the UN in all these areas

- We should strengthen open trade in the new round of negotiations and get rid of all our tariffs and quotas which undermine the EU's credibility as a promoter of open trade and global development.

- We should develop a common strategy on how the Union should promote human rights globally.

- And all member states should make rapid progress towards the 0.7 per cent target for official development assistance so that the Union can show, at next year's Conference on Financing for Development, that we are prepared to go from words to deeds.

We need greater coherence in our policies. We cannot speak about a truly coherent Common Foreign and Security policy if trade, development, migration and environment are not integrated. In practical terms, this means better co-ordination between policy areas and pillars, and between the different voices of the Union on foreign policy – the Presidency, the Commission, the High Representative and the Member States.

And let me say that it is not as difficult as some might think to attain an effective common foreign and security policy among 27 countries; even today the candidate countries associate themselves with most EU statements.

Ladies and Gentlemen,

Let's all stop for a second and ask ourselves – what kind of Europe do we want? That should be the point of departure for the debate on the future of the European Union, before the new Inter-governmental Conference in 2004.

To me, the challenge is to create a Europe with more and better jobs.

Therefore the EU needs a sustainable development, where economic growth and social cohesion are mutually supportive. We must, despite the uncertain economic outlook, vigorously pursue our economic reform agenda. But we must, at the same time, continue to modernise our social and welfare systems to offer security in times of change, and to promote labour participation. Social welfare systems should be seen as productive factors. The EU is already in need of additional labour force, which will require a sound and humane migration policy. These matters should be discussed during the Union's Spring Summit in Barcelona, next year.

To me, the challenge is a Europe with a sound environment.

Therefore in Barcelona we should address the environment, in particular climate change, and make progress on sustainable transport and energy systems. We need to decouple economic growth and increased pressure on our environment. Investing in environmental technology contributes to both growth and employment.

To me, the challenge is an efficient and transparent Europe.

Therefore, agricultural and regional policy – and with them budgetary policy – will need far-reaching reform. It’s not needed because of enlargement – reforms are already long overdue. The Common Agricultural – or should I say Anachronistic –

Policy was once conceived for a quite different situation, when Europe was threatened by food scarcity. Today, it restricts market access for other countries. Today, its subsidised products destroy the market in candidate countries and the third world. Today, it is often contrary to sound environmental policies. Today, it is also a heavy financial burden. It costs over 40 billion euro per year, making up almost half of the total EU budget. We can forget about legitimacy among the citizens if we can't create a sound system. They want a system that promotes a good environment, animal welfare and biodiversity. I read in the newspaper today that only one third of EU citizens find that the CAP fulfils its goals. The question is not whether CAP should be reformed, but when and how.

I am sure you have more visions for Europe's future, as have our citizens. And that is where the debate should start. It is obvious that the scope of the upcoming Conference will be wider than the four specific issues already decided and that we will see many radical suggestions. But let us not forget that the present structure has served us rather well, and evolved step by step. I see no need for fundamental changes in the overall balance between the institutions. But with that balance largely intact, there are still plenty of things that can and should be done. We are certainly ready to discuss simplification, a clearer definition of competencies, a Basic Treaty, and we are certainly in favour of more majority decisions in certain areas. Transparency and improved public access to the decision-making process are obviously needed – and we have only made a modest beginning in that area. Changes in the rotation of the presidency should be discussed. Better co-ordination between different presidencies can be introduces promptly and need not wait until the IGC.

A language reform is necessary. Citizens and elected politicians should always be able to use their own language in contacts with the institutions. But diplomats and officials could cope without. If the United Nations can manage with six official languages, the European Union should be able to cope with fewer.

Ladies and Gentlemen,

Europe is more than a market: our Union is based on core values and freedoms and solidarity are encouraged. Our Union is a unique co-operation that serves as an example to others.

Enlargement will make the Union stronger and – to go back to Bob Dylan – even if it is a bumpy ride for the candidates – I hope everyone will be there to greet them in two years time.

Europe Goes East

Mihai Nicolae Tănăsescu

Mr. Chairman,
Mr. Commissioner Verheugen,
Distinguished Guests,
Ladies and Gentlemen,

I am very pleased to be here with you today to discuss matters related to European integration. It is an honour as well as a challenge.

Before introducing to you the latest macroeconomic developments, please allow me very briefly to point out some of the key elements that define our recent history.

In this respect, I would like to mention that a considerable turnaround has been realised in the Romanian political life after the November 2000 elections.

The reforms made by the rulling party since the elections, significantly improved the functioning of government. Inter-ministerial co-operation has increased, as has the policy-making capacity of the administration.The efficiency of the legislature, which had been recognised as a particular problem in the previous political structure led by a six parties coalition, has increased substantially.

The combination of a government with a strong position in both houses and reformed parliamentary procedures has seen the number of laws adopted by Parliament increase significantly since the beginning of the year. This has allowed the legislature to effectively process the backlog of some 700 hundred draft legislative acts left over from the previous government. The improved functioning of Parliament has been matched by the government's reduced reliance on ordinances and emergency ordinances as legislative instruments.

The increased political stability will help us to focus on the institutional and economic reforms needed to speed up the euro-atlantic integration process.

Romania is convinced that, in the globalization and integration processes, a candidate member country to Euro-atlantic structures must supply stability in the region and must prove its ability in a constructive cooperation over its border. The role played by Romania in the region, within the Stability Pact and in the chairmanship of OSCE, is a token thereof.

Around three-quarters of the Romanian population, the highest ratio among the integration candidate countries, supports the European and NATO integration processes. This demonstrate very clearly that our commitment to the EU integration is sustained by a broad-based consensus between the political forces, civil society and the overwhelming majority of the larger public.

Though Romania has been one of the laggards in the progress towards EU accession, the situation is quickly improving. Until now, Romania has opened seventeen accession chapters and has provisorily closed eight of them. The Government expects to prepare and present to the EU Commission the remaining chapters, and in 2002 to open the negociations for all chapters.

Ladies and Gentlemen,

Related to the economic side, I would like to mention that a considerable improvement has been shown recently in all sectors.

Certainly, the most important thing is that the economy grew by 1.6% in real terms in 2000, turning the growth rate to above zero for the first time during the last four years. In 2001, the trend strengthened and the economy is expected to grow by 5-5.5 percent, the fastest growth rate in Central and Eastern Europe and well-ahead of the official target. The main objective, in the medium and long term of the Romanian Government, is to maintain an economic growth rate of around 5 percent, bringing down the inflation rate to a single digit figure before 2004 and containing the current account deficit within sustainable boundaries.

Taking into account the latest developments in the international economy after the terrorist attacks from New York and Washington, our goals may appear quite challenging. After discounting the latest information available on the market, we still believe that the Romanian economy will be able to grow for the next year at least at a rate of 3.5-4 percent. This is the result of two opposite developments. On the one hand, the growth of exports will be affected to some extent by the last events, due to the fact that over 65 percent of Romanian exports are absorbed by the European market and the growth rate of the continental economy will be diminished by the global economic downturn. On the other hand, the previous effect will be fully compensated by the acceleration of the microeconomic restructuring process caused by the speeding-up of the privatisation process and by the hardening of budget constraints determined by tax collection improvement.

In the last period, there has been a peculiar progress in the disinflationary process. Inflation is forecast to decline to its lowest level since 1995, although we do recognise that we still have to address this issue in a more convincing way. For 2001, the objective is reducing the inflation to a level of 29%, this being perceived as the first step for reducing the level of inflation to a single digit by 2004. The monetary policy will play a more important role in this area, as the official status of the National Bank of Romania will be modified, its independence will be strengthened and its efforts will focus only on the inflation objective. The monetary policy will find support in the implementation of other macroeconomic policies as well as in the structural transformations which will result from the acceleration of the privatization and restructuring process.

The main objective of the Romanian Government is also to pursue a fiscal policy oriented toward the preparation for EU accession, improvement of social conditions by supporting policies in health, education and environment, and development of the economy through investments. The focus of our fiscal policy measures will be on increasing the equity, transparency and efficiency of the tax system. The principle instrument will be the reforming of the tax administration.

The Government is determined to take the needed steps in order to increase budgetary revenues and to attain the previoulys stated goals. As the economy is expected to grow by at least 5 percent in the following years, the total revenues are projected to increase from 32.7 percent of GDP in 2001 to 34.6 percent of GDP in 2005. The expenditures will increase from 36.2 percent of GDP in 2001 to 37.6 percent of GDP in 2005. From 2002 onwards, the budgetary deficit will be maintained under 3 percent of GDP.

As regards the external position, Romania has one of the lowest debt burdens even when compared with better-rated countries, and external debt service is manageable.

The general government debt stands at around 27 percent of GDP. This ratio has been fairly stable over time. The outstanding external public debt as of August 2001 reached the level of USD 7.7bn, out of which 68% represents external public debt contracted directly by the state, and 32% guaranteed by the state.

The external debt service of the public sector is on the decrease, reflecting partial repayments of public external debt and the transformation of the maturity structure of external debt into a longer spectrum. This hit the peak at US$2.2 billion in 1999, and is expected to decrease to around US$1.9 billion in 2001 and 2002 respectively. Romania's foreign exchange reserves (excluding gold) already increased to US$3.6 billion at the end of August 2001. Consequently, the capacity of external debt service of the country has significantly strengthened.

The improved external performance made it possible to re-enter the international bond market in late 2000, and was also reflected in this year's upgrade of Romania's sovereign bonds.

The agreements recently signed with the IMF and the World Bank, as well as the EU's positive assessment and increasing aid, indicate Romania's improving international standing.

We are fully committed to speed up the privatization process, whilst emphasizing the quality aspect of the process, targeting serious investors with the required financial resources and expertise to carry through a full company turnaround.

Sidex, the largest Romanian and East European integrated steel producer and second largest generator of arrears in the domestic economy was recently privatized. The Sidex privatization spares the state budget from large and persistent losses and stands proof of the Government's political will to complete difficult privatization cases, from a social point of view.

We will focus on privatizing SOEs with critical mass in the economy and with large spread-out effects. Ownership transfer of large SOEs targets efficiency and competitiveness gains, but also enhanced hard budget constraints and social welfare preservation. Due to these companies' complex situation, transfer of property will be achieved on a case-by-case basis.

The stock of the non-performing loans in the banking sector diminished considerably. Key factors in this evolution were the dissolution (by acquisition) of Bancorex, the main state-owned bank financing foreign trade, the restricted operations of a number of ailing banks and the successful privatization of two large banks (Romanian Development Bank and Banca Agricola). Romania's banking system is sound, well supervised and adequately capitalized.

Plans are set for further downsizing the state's stake in the banking sector, through the privatization of Romanian Commercial Bank (the largest bank in the system) and CEC (The Savings Bank). These measures, correlated with the tax collection improvement, will harden the microeconomic budget constraints and will indirectly speed up the restructuring process.

I hope that the recent improved business and investment environment in Romania will also be taken into consideration by the western banks in assessing a better country risk rating, which will encourage the investments in the Romanian financial market. Especially German banks, which still regard with reserves Romania, are wellcome to use the new opportunities.

Recognizing the fundamental role of private sector-led growth for sustained economic and social development, the Government of Romania is committed to promote a stable, neutral and efficient business environment. As general principles, we will focus on removing barriers, disincentives and distortions that discourage investment and diminish the use of tax holidays and special deals for investment promotion. Investment (foreign and domestic) is yet to have a significant impact on the Romanian economy as a whole. This becomes even more visible if compared to other transition countries in Europe.

Numerous changes in legislation and facilities offered, have constituted a serious barrier to investment (particularly FDI). Therefore, an important goal of the Government of Romania is to simplify and unify legislation concerning enterprises, providing for an even treatment in accordance with EU legislation. All pre-existing investment legislation will be compiled, duly cleansed of all redundancies (and in respect of the transparency principle), into a unitary direct investment code. In this regard, a new law has already been passed (Law 332/2001), referring to a set of fiscal incentives only for investments exceeding USD one million.

The main objective for the macro-economic policies in the next period is to stabilise the economy and to put it on a durable growth path, with the final goal of increasing the standard of living in Romania, by continuously reducing the existing gap that separates Romania from the average European Union standard. At the same time, we envisage creating the fully functioning mechanism of a market economy, able to cope with competitive pressure within the European market. Joining the European Monetary Union is our long-term objective in the economic area and I wish to inform you that almost two weeks ago we forwarded to Brussels our Pre-Accession Economic Programme, in which we propose, among others, the conclusion of a Tripartite Agreement for Growth and Social Prosperity, which aims to foster the sustainable economic growth of Romania by safeguarding the disinflation target, promoting sound job creation, and protecting living standards.

Turning now to the social and financial challenges of enlargement, I believe they can be summarized into a single question: how to keep the Union functioning with the same fundamentals, i.e. its core principles of solidarity and cohesion, including financial support, after enlarging with countries with different economic situation and social backgrounds?

I think that this dilemma will be top of the political agenda in 2004, in the framework of the next Inter-Governmental Conference, the discussions on the next financial framework of the EU and the campaigns for the European elections. At the same time, the international financial institutions should have to agree on a financing strategy of the candidate countries to the EU.

To summarize, Romania wants to join a single-speed Europe, based on the principles of solidarity and cohesion. From this perspective, the last declaration of the French Foreign Affaires Minister, related to the enlargement of the European Union in 2004 and the inclusion of Romania and Bulgaria together with the other ten candidate countries, is very encouraging.

We perceive this declaration as an effective consequence of the conclusions of the European Council of Goteborg regarding the assistance of Romania and Bulgaria in order to reduce the gap that separates them, compared to the more advanced candidate countries. The Romanian Government is ready to discuss, with the European partners, a special program to reduce the differences and to allow for the reassessment of the adherence calendar in the direction mentioned by the French Foreign Affairs Minister.

In order to succeed in this program, Romania is very realistic about the necessity to speed up economic and institutional reforms, according to the recommendations of the European Commission and to the Governing Program.

All in all, continuing to pursue macro-stabilization measures, structural adjustment of the economy, and creation of the favorable business environment, based on a coherent and stable legal environment – represent the main options and responsibilities of the Government in its striving to promote sustainable economic growth and a functioning market economy, compatible with the principles, norms, mechanisms, institutions and policies of the European Union.

Europe Goes East

Günter Verheugen

Thank you very much. I've been in Frankfurt since yesterday afternoon and I have already heard two very tough messages: One yesterday night, at another meeting, from Helmut Schmidt, the former German Chancellor, saying that Europe is totally bogged down and that the whole concept of enlargement is a mistake, very blunt as always. And another this morning from Mr. Fahrholz, saying that enlargement is underprepared and underfunded. So now I have an opportunity to hit back a little bit this morning. First of all, I would like to put the enlargement project into a broader perspective. The broader picture is that the EU is facing four important challenges at the same time: reform of its institutions and policies, enlargement, defining and implementing its role as a global actor, and finally, implementing the Lisbon strategy, i.e. a ten-year timeframe for making Europe the strongest and most competitive knowledge-based economy in the world. That final item is perhaps stretching things a little, but it is what our leaders have decided. Consequently, we have a lot on our plate at the same time. And we have already started the work. We are moving ahead.

However, this morning I shall concentrate on enlargement and reform, because the two issues are closely linked. As a starting point, I must stress that there is no alternative to enlarging the EU. You cannot compare the present enlargement process with any of the earlier ones. It is a completely different and unprecedented historical situation. What we are doing right now is repairing some of the damage left over from the history of Europe in the twentieth century. At last the distortions arising from the first and second world wars will be corrected and we will have a Europe of peace and stability based on shared democratic values . The strategic aim and objective of enlargement is not to have more regulation, certification, production quotas and so on. As I said yesterday, enlargement is not about the competitiveness of barber shops in border regions, it is about peace and stability for Europe. What is the alternative? How do we bring about lasting stability, political and economic stability, in the part of Europe that belonged to the Soviet bloc, that fell victim to the two most violent ideologies of the twentieth century:

national socialism and Stalinism? Without the prospect of membership, we could never have achieved even the present level of economic, social and political reform in these countries, which has already brought about a considerable measure of political and economic stability. Without the prospect of EU membership it would not have happened. Do you really believe that the people of these countries would accept the huge burden of political, economic and social transformation without a clear and credible prospect of membership ? We cannot move the goal posts after the game has begun. It is not possible. The process is irreversible; what we have to do is to ensure that the right balance is struck between the speed and quality of that process.

We have reviewed the strategy since the terrible atrocities of 11 September, and asked ourselves,: if nothing will ever be the same again, as people are saying, what about enlargement? Well, that is something that must stay unchanged. European integration, the most successful idea in the history of Europe, will extend the area enjoying peace and stability to Central and Eastern Europe. This has become even more important since the advent of a new and terrible global threat.

Now, what is the state of play? The progress of the candidate countries was assessed last week in the regular reports. I must admit, I don't feel too comfortable as a teacher for thirteen countries and I try not to lecture them. So I can say that the candidate countries, with the significant exception of Turkey – I will not discuss Turkey in my statement – meet the political criteria and ten of them are already close to fully meet the economic criteria. They are functioning market economies and in the fairly short term they will be competitive enough to withstand the pressures of the internal market. The weakness is the same everywhere: they still need to improve their administrative capacities, and especially the judicial system. This is extremely important in countries where we need a steady flow of foreign direct investment, because if the legal environment is not transparent and stable for investors, they will stay away. That was the problem, for instance, in Romania. I am very happy to see that the new government in Romania has started to tackle that. The Commission has presented an action plan to improve administrative capacities to make sure that new member states will be able to implement and enforce European legislation properly upon accession. I think we can realistically hope to conclude negotiations with up to ten countries before the end of 2002, in other words, all the negotiating countries except Romania and Bulgaria. For those two countries we intend to set out a special road map and pre-accession strategy to avoid any impression that we are leaving them behind.

The Commission will make its recommendations on the basis of objective criteria. As there was a discussion this week in the General Affairs Council in Brussels and some coverage in the press, I would like to make this quite clear: there is no political guidance or political input for the regular reports. They are based on assessments by hundreds and hundreds of experts – including experts from your institutions- and I do not believe I could influence the assessment of your experts. These regular reports are the basis for our strategic recommendations, not the other way round, though one important Member State seems to believe that there is a political strategy and we then slant the regular reports to provide justification for it. That is not the case; the Commission will make recommendations based not on political or strategic considerations, but on merits and the actual state of preparation, and our judgement will be as fair as possible, but also as critical as is necessary. But my expectation is that the negotiations can be concluded and these ten countries will be able to meet all the criteria.

I know that some of the negotiating chapters are regarded as extremely difficult, especially agriculture, regional policy and the budget. I have to say that regional policy does not pose major problems, indeed we will be presenting a comprehensive paper in a couple of days. This chapter is technically difficult, but not politically. On agriculture, we started preparing the candidate countries many years ago. It is wrong to think that we are just starting out, we have already made considerable headway in candidate countries. Four key questions remain to be solved. The first is: How far do we impose our complex and cumbersome market organisation structures on new member states, knowing already that the system is going to be reformed? That is one critical question. The second has to do with production quotas, but that of course is part of the normal bargaining process. Then there is the question of direct payments. There we have to understand that the assumptions underlying the Berlin Agenda 2000 decisions are no longer valid because in some sectors and some countries agricultural prices are already higher than in Member States, and consumption and production levels are different. So we have to reconsider this. But in my view the most important and the most difficult problem here is quality standards. How can we guarantee that veterinary and phytosanitary requirements are met in full? That needs a lot of investment and a lot of reform.

As far as Monetary Union is concerned, I would like to make it plain, particularly here in Frankfurt, for obvious reasons, that nobody thinks accession to the EU automatically means joining EMU at the same time. We tell candidate countries that their first priority is to meet the Copenhagen economic criteria for accession and only after that should they try to meet the Maastricht criteria for the

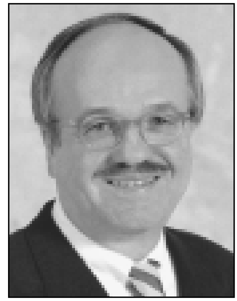
European Monetary Union. And there is no pressure from our side on candidate countries to move faster.

Moving on to the reform and the question of financing, I agree, although Mr. Fahrholz said that he feels the working of our institutions, their efficiency and transparency, is probably inadequate and likely to be even more so after enlargement. But I would also echo what Anna Lindh said: The need for reform is overdue already and has nothing to do with the coming enlargement. The problems which we have in the European Union today date back to previous rounds of enlargement. What is more, since those earlier rounds we have lost a common vision of the future of Europe. With no common vision it is extremely difficult to decide what we have to do next. If you do not know where you are going, what your final goal is, it is hard to decide what the next step should be. That's the problem that we're facing. But I agree, things are not likely to get easier with 27 members. I do not believe we can improve the efficiency and transparency of the institutions without giving them greater democratic legitimacy. In my view it is a constitutional issue. We have to increase the European Parliament's powers and subdivide those of the Council. Insofar as the Council acts as a legislator it must follow normal parliamentary rules. I cannot understand why we should organise the European Community in a less democratic way than the Member States. I agree also that a 27-member Commission will be unable to carry on working as it should. I can tell you that when the present Commission discussed the question of size and composition a very small minority, and as usual I was part of that minority, said the Commission should get smaller, not bigger. The problem here is that smaller Member States in particular cannot accept the idea of being without a Commissioner. In Luxembourg, Austria, Sweden, the smaller countries, we're talking in terms of someone close to Prime Minister, foreign minister status, an extremely important person and someone who gives the country a voice in Brussels. So the smaller Member States do not accept the idea of a rotating system. It will not work the way things are, and I have plenty of ideas about structural reform. But more important than institutional reform is undoubtedly the reform of policies, especially agricultural policy, regional policy and the structural funds. The Commission will be presenting proposals quite soon – next year for agricultural policy, then for regional policy in 2004 and for the next financial package, which will be a reform package, also in 2004.

The financing of the present enlargement process poses no problems until 2006. That is understood, I think, and you did not see this as a problem in your study, Mr. Fahrholz. We have ceilings, and the Commission has already said it will not make proposals which go beyond these ceilings. Nor will we make proposals which would commit the European Union financially after 2006, obviously. So the question comes in 2004, 2005 and 2006, when we have to decide the next financial perspective. Mr. Fahrholz suggested that the new Member States will be in a position to blackmail us and prevent us from cutting spending. In any case they cannot force us to raise spending. So it will be a question of finding a balance. As you know, the European budget is fixed – we can't levy direct taxes or borrow money – and I can tell you that the Member States, especially the net contributors, will not accept a European budget that is liable to soar out of control or basically even expand significantly. The problem after 2006 therefore will be dividing the same cake among a larger number of recipients. Yes, this is a political problem and it must be solved. But remember the limited absorption capacity of candidate countries. Nobody asks how much Spain "costs" because everybody understands that what we are doing in Spain is a very sound investment. It has already paid off and it will continue to pay off. I am convinced that the same will be true of the candidate countries. Everybody agrees that it will be a win-win situation. We will not be paying for these countries to meet environmental , social or agricultural standards. They have to bear the cost themselves and they will therefore need long transition periods. It will obviously take them a very long time to catch up, but I think we can live with that. In the case of Ireland, the turning-point came after about eighteen years and I think we will see more or less the same in the candidate countries. I know that there are risks and there are many problems but we are aware of those risks and problems and they are manageable.

Europe Goes East
Closing Remarks

Bernd Fahrholz



Ladies and Gentlemen,

As a law of nature, time is short and there are no exceptions. Not even for the European Banking Congress. Nevertheless, we used the time available extremely efficiently and gained some highly pertinent first hand information on the enlargement process. I would like to thank all panelists for sharing their perception of "Europe goes East" with us. Thank you very much!

It is another law of nature that most things in life are ambivalent. There are hardly any exceptions and there definitely isn't one for the eastward enlargement of the European Union. It can contribute significantly to European security and political stability and at the same time will increase the Union's international weight.

But along with these obvious political advantages, admission of the candidate states will also have a significant economic impact on the EU as an institution, on the accession countries and on the current members. However, this impact will depend heavily on the general conditions created for enlargement.

Enlargement to the east requires all parties concerned to show a substantial willingness to implement reform. It offers the Union the opportunity to part with inefficient subsidization mechanisms and traditional structures – for the question of who will pay for the costs of enlargement is still topical. More efficiency, transparency and closeness to the people may help bolster public support for the European idea.

For the candidate states, EU entry before completion of the reform process would not only mean receiving welcome aid, but also becoming dependent on European subsidies.

Ultimately, all EU countries have to decide how they wish to define their own position within the Union as well as the role of the Union as a whole, what contribution they themselves are willing to make and what they expect from Brussels.

It is up to Europe to continue the success story of the integration process, but it is necessary to lay the foundations today and to do it in the right way.

Ladies and Gentlemen,

thank you very much for your attention and I hope you profited from this first panel as much as I did. And now, bowing to other as yet unmentioned laws of nature, we shall take a break. We will start the second panel at 12 o' clock.

Banking on Eastern Europe

Klaus-Peter Müller

Ladies and gentlemen,
This panel is devoted to the topic "Banking on Eastern Europe". And I don't think that anyone here will disagree with me when I say that banks and financial institutions have been the driving forces behind the integration of the Eastern European countries.

The first panel this morning showed that the political preparations for EU enlargement are more complex than economic integration. In hardly any other area has the transition process been so impressive as in banking. The most rapid changes and upheavals have occurred in the young, transitional market economies of Central and Eastern Europe which have demonstrated a great capacity for innovation.

This almost makes Eastern Europe a model for Western Europe's banking markets with their need for further structural improvements, especially in Germany, and for the emergence of a truly integrated European capital market.

Enlargement of the EU will lend extra momentum to the creation of a modern and innovative banking market in Eastern Europe. At the same time, this market is also affected by the changes in banking worldwide, such as efficient banking supervision, Basel II, securitization, and multi-channel banking.

If we want to tackle such an important and fascinating topic as banking on and in Eastern Europe, we naturally have to examine and compare various standpoints. In short, we need a panel with the right composition – people who represent different perspectives and types of experience.

I think we've really done very well in this respect as far as our four panellists are concerned. Next to me, I have two heads of supranational institutions and two CEOs of private-sector banks. They also form an ideal balance, with two speakers from Eastern Europe and two from Western Europe. All of them are either very active or exclusively working in the financial and banking markets of Central and Eastern Europe.

They have witnessed and helped to shape the changes of the past few years. They all share an interest in greater integration and the further development of both banking markets and economies. Reflecting their individual functions and goals, they use different approaches and strategies.

So, as panellists, let me now introduce:

- Jean Lemierre, president of the European Bank for Reconstruction and Development (EBRD) in London. Previously, he served as chairman of the Paris Club. As a member of the European Monetary Committee from 1995 to 1998, he is also an expert on monetary issues. And while director of France's treasury, he was involved in the partial privatization of France Télécom and Air France. As a result, he combines in a single person all three key components of our congress – the political, the banking and the monetary. I very much look forward to his statement on Eastern European banking.

- Our second panellist is Alessandro Profumo, CEO of UniCredito Italiano, who began his career in 1977 at the Italian Banco Lariano. While working at the consultants McKinsey and Bain, he advised financial service companies. Today he is chairman of one of Italy's – and even Europe's – largest and most profitable banks. UniCredito is one of the major international financial institutions that invest in the Eastern European banking market. Mr. Profumo has experience in taking over and restructuring banks in this region, and I'm sure he is going to tell us something about that.

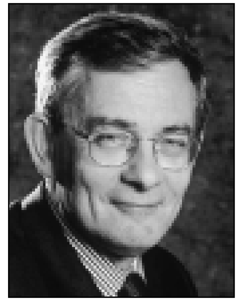
- Thirdly, I welcome Josef Tošovský. In Mr. Tošovský, we have an expert who received the IMF's Central Banker of the Year award in 1993 for his efforts in reforming the Czech banking system. And further awards followed. The stations of his career include the former State Bank of Czechoslovakia, where he became president in 1989 and which he rebuilt as a Western-style national bank. Following the split of Czechoslovakia, he was appointed governor of the Czech National Bank. As prime minister of the Czech Republic, he formed a caretaker government for six months, which among other things pressed ahead with the privatization of banks. He is now making his experience available to the Financial Stability Institute at the Bank for International Settlements in Basel, whose chairman he has been for almost a year now.

- Last but not least, I welcome Wojciech Kostrzewa. He is president and CEO of BRE Bank, which is primarily active in Polish corporate and investment banking, and is now building up its retail business as well. The press once referred to him as the “magician of Polish banking”. And I imagine that he'll share with us his recipes and his interesting experience in one of Central and Eastern Europe's most progressive banking markets.

These four expert panellists present us with a whole spectrum of visions and concrete plans for integrating and strengthening the eastern wing of the European house.

But that's enough by way of introduction. Let's now listen to the experts and debate with them.

Banking on Eastern Europe



Jean Lemierre

I am very pleased to be here this morning. I will try to make some simple remarks about the banking sector in the transition economies. I should explain that as far as EBRD is concerned the transition economies mean the whole eastern part of Europe, not just Central Europe and the Baltic States. I would like to start with a general remark related both to the framework and the future of the banking sector. The enlargement process presents an extraordinary opportunity to the banking sector, the economies and the people of the region. It is not up to me to comment on the process itself, you heard about it this morning. From a macro-economic point of view, however, it is a key challenge and a key opportunity, not only for Central Europe, but also for parts of Eastern Europe and for all the countries in the region. It means improved growth, better and increased trade and probably more competition. It can bring simple improvements even if the way there may be difficult, but it is also clear that this is a huge challenge for everybody. I would also like to mention that this is true even for sensitive sectors, such as agriculture and steel, because it will force restructuring of these activities. As this is a challenge as well as an opportunity, the banking sector must be able to provide the appropriate financing for the real economy. My point is, therefore, to comment not so much on the banking sector itself, but on the role of the banking sector in providing financing for the real economy.

Ten years ago the process of reforming or creating a banking sector was certainly seen as a long-term process. The achievements have been formidable in many countries. However, the banking sector unfortunately still lags behind where it should be, and there is still a lot of progress to be made. This is a key element from my point of view. Unfortunately, even today, the ratio of the total domestic bank credit to GDP is well below what is standard in Western Europe. There has been a great deal of consolidation and progress in the banking sector, yet the level of intermediation still remains low. Despite this progress, the capacity of the banking sector to provide long-term financing is still limited. What do I mean by this? I mean simply that we have to work hard to improve the situation and that this work is in hand. If it were not, we would soon reach a bottleneck. This is the link I made between the extraordinary opportunity presented by enlargement for all the countries in the region and the necessity to have a very powerful, sound, efficient banking sector in these countries.

EBRD has taken a part in this. I think we are one of the most important players in the restructuring and creation of an efficient banking sector. I could give you many figures, but there is one particular figure which is quite interesting: the share of EBRD of the banking assets of the region. If you compare EBRD's total exposure to the total banking assets in the region, EBRD's share is 49 %, i.e. nearly half of the total banking assets in Central Europe and the Baltic States, a little less than 40 % in the Southeast of Europe, and 45 % in the CIS countries. These figures show our commitment to improving the situation.

Having said that, what are the most difficult questions still to be addressed, taking into account the fact that the situation is not the same in all countries? My first comment is about the pace of reform which has differed from country to country. Some have moved very quickly in a transparent, efficient way to open up their banking sectors. Clearly this is the best situation. Others have encountered political and fiscal constraints, and have only recently begun to change. Unfortunately, in some countries parts of the banking sector are still administered as they were a few years ago, to provide subsidies to certain companies and for certain activities. It is there that progress must be made.

My second comment is that it is clear that the entry of foreign investors in the markets has been a tremendous catalyst for progress. I know it is difficult, both for political reasons and for social reasons. In any case, supervision must be tough and strong. This is part of a difficult, long-term process which is moving forward, but still requires our support.

What should we focus on? Certainly, I would mention corporate governance first and foremost; corporate governance of the banking system, but also corporate governance of clients. The banking system needs good, transparent and sound clients. The accounting system is becoming a crucial element. The legal framework is also still an important issue. It is not the same everywhere, but it is important. Respect for standards, well implemented by the supervision agency, is also a key element. The co-operation between the supervision agencies of the West and the transition countries has helped enormously. I would like to add one further point of particular importance these days, but which, unfortunately, has raised some questions: the implementation of rules against money-laundering. This is a crucial point. The FATF and the OECD should be very satisfied with what is happening. The sound implementation of these rules is certainly the best demonstration that the banking sector is moving in a positive direction. This is an issue for the public authorities.

With regard to the banking sector itself, what are we trying to do at EBRD? The first task is to help create clients. Efforts with regard to SMEs is a crucial element. The creation of an SME market is very important for a number of reasons, and we are co-operating with many German institutions in this field. We are also working to support the development of consumer financing, meaning we have to create a whole new market. So the first element is to create new, sound markets with clear rules.

There is a second point with regard to the banks and this is the customer orientation of the banks and the service attitude of the banking system.

In one word, to sum up: yes, the banking sector has a key role in the accession process, and a key role in financing the economy. It has moved forward and you have given it a lot of attention. What has been achieved is regarded by the EBRD as quite marvellous. Nevertheless, there is still much to do. A sound partnership between public institutions, governments, central banks, which must play a leading role in this respect, and the private sector will be vital to help the banking sector in the transition countries. Dialogue and the discussion of ideas and questions can lead to a lot of progress.

Banking on Eastern Europe

Wojciech Kostrzewa

Ladies and Gentlemen,

The title of this panel is a nice play on words and as president of one of the most successful banks in Poland it gives me personally the opportunity to convince you not only that you can Bank on Eastern Europe and on Poland in particular, but that you can also Bank on Banking in Eastern Europe and Poland. And I think you will not be surprised if I use the banking landscape in Poland and BRE Bank as examples in my line of argument.

Let me start by providing an overview of the Polish banking system followed by a few comments on how the banking industry there has developed differently during the transition process compared to other countries in the region.

Polish Banking Sector

Poland has a two-tier banking system since 1989, when the functions of the central bank and commercial banks were separated. At that time, the National Bank of Poland was divided into a central bank and nine regional banks (then still state owned), to add to the existing five banks (Pekao, Bank Handlowy, PKO BP, BGZ and BRE Bank). In 1990, the number of commercial banks had already reached 75 due to the new liberal approach to licensing and opening of new banks.

Now, there are 69 commercial banks (down from 73 at year-end 2000) and 663 cooperative banks operating in Poland. With respect to concentration, the five largest banks account for 50.5% and the fifteen largest banks for 81.4% of total bank assets. This trend is expected to intensify and it is estimated that, by the end of 2001, the 10 largest banks will have 82% of the system's total assets, 86% of non-financial deposits (mostly still PKO BP and Pekao S.A.) and 78% of outstanding loans. The number of banks will further decline because of mergers triggered by shareholders. Consolidation will also come because many small banks cannot comply with capital adequacy requirements. Despite the large number of entities, the cooperative banking sector is of very low importance in terms of assets (4.3%) and deposits (5.2%). Nowadays, there are hardly any new banks being set up, one exception recently being a license granted to a Japanese bank.

The Polish banking sector is mostly privatised. The number of banks with a 'majority public sector interest', i.e. equity entitling the Treasury, the NBP or other public institutions to exercise at least 50% plus one vote, now totals seven, down from 13 at the end of 1998. The Treasury directly holds a dominant stake in only three large banks, which combined account for 22% of assets, 28% of deposits, but only 11% of capital. These three are PKO BP, the largest retail savings bank, BG (the abbreviation stands for Food Economy Bank) as an institution comparable to the Germany's DG Bank, and BGK, which can be compared to the German KfW. The controversy and heated political debate in Poland about PKO's privatisation has certainly been noticed outside of Poland and often sparked concerns whether the protective behaviour of the Polish government regarding PKO is a sign of reversal of the privatisation process. Set aside the possible scenarios of PKO's privatisation, I would like for all sceptics to reconsider their view in light of the fact that even without privatisation of PKO, the share of private banks in Poland is significantly higher than in many Western European countries, including Germany, where more than half of banks' assets are not privately owned!

The banking industry is still the leading and most mature segment of the Polish financial market, with sector assets at the end of 2000 accounting for slightly less than 90% of total assets of the financial services sector (banks, brokerage houses, pension funds, insurance companies, mutual and investment funds). Stock-listed banks account for 35.8% of overall market capitalization of the Warsaw Stock Exchange.

There are 11 Polish banks rated by international rating agencies. In most cases the ratings reflect the positive influence of their foreign strategic investors, who are thought to support the banks and improve their managerial skills. Although rating agencies have recently taken a more prudent view on Polish banks because of the generally challenging environment the banks operate in at the moment, most senior long-term ratings are at the top level of the sovereign ceiling.

The role of foreign investors

Out of the 62 private commercial banks, 44 are directly and indirectly foreign-owned. Foreign investors hence control almost 79% of capital and 68% of total banking sector assets. In terms of loans and deposits, their share is 72% and 64% respectively. With respect to foreign investment and consolidation in banking, some major events last year have been the acquisition of Bank Handlowy by Citibank, Deutsche Bank taking over troubled BWR and converting it into Deutsche Bank 24, Eureko and Banco Comercial Portugues taking a majority stake in BIG Bank, Bank Austria taking control of Powszechny Bank Kredytowy, and in our case Commerzbank increasing their stake in BRE Bank to 50%. This year so far we have seen the merger of WBK and Bank Zachodni, both banks being majority owned by Allied Irish Bank, the merger of ING with Bank Slaski, and the merger of three small banks, all controlled by Nordea. From January 2002, Bank Przemyslowo-Handlowy and Powszechny Bank Kredytowy (subsidiaries of Hypovereinsbank and Bank Austria) will be listed on the WSE as a merged entity.

Foreign investors try to realise a variety of strategies: Some see Poland as an extension to their home markets (Bank Austria/HypoVereinsbank). Others have little growth opportunities left in their home markets and therefore turn to new ones (AIB). KBC implements its bancassurance approach, using bank networks to sell insurance and other products, while others take consumer finance as the stepping stone into Poland, like GE Capital. Very often the ‘detour’ of financial intermediation is the only possibility left for foreign institutions to enter a market in which the last privatisations have seen extremely high prices paid for entry into banks.

Challenges ahead

However, there is lot of room to grow and market shares to be gained. Poland can still be considered underbanked. According to Moody’s, the total assets of the 100 largest Central and Eastern European banks were just over USD 200 bn in 1999, which is not even half of those of the largest single bank in the UK, Switzerland, France, Germany or the Netherlands. The ratio of banking assets to GDP is slowly increasing to 62% in 1999, up from 60% a year earlier. Nontheless, this is still one of the lowest ratios in Europe. The same is true for deposits to GDP at 38% and loans to GDP at 30%. Housing loans account for only 2% of GDP compared to 8% in Greece and 40% on average in Western Europe. This offers huge growth opportunities for mortgage banks, among which BRE Bank’s subsidiary

Rheinhyp-BRE Bank Hipoteczny (a joint venture with Commerzbank's Rheinische Hypothekenbank) is well positioned. As the first mortgage bank in Poland it has the first mover advantage and will benefit from the fact that it is the only representative in Poland of Germany's new mortgage bank Eurohyp.

Over the last months, the investment banking business has been suffering from the general slowdown of capital markets and the slowing pace of the privatisation program. Declining levels of trade on the Warsaw Stock Exchange and the lack of interest in IPOs has hit investment banks. The well-established investment banks and those domestic banks with regional expertise are holding out, whereas others have already withdrawn and closed offices in Poland including Robert Fleming, Wood&Company, Raiffeisen, and the asset management entity of ABN AMRO.

The comprehensive modernisation of Poland's pension fund system with a three pillar structure and privately managed mandatory and voluntary schemes, along with private insurance companies, are now the backbone of domestic institutional investment, and channel a growing amount of funds through the capital market. A relatively high degree of liberalization enables large corporates including foreign ones to borrow abroad. Medium-sized corporates are being wooed by the bulk of domestic corporate banks which offer them access to the less heavily regulated segments of the private capital market. Small firms, however, still face difficulties as banks are not keen on serving this market segment. In this context it has to be acknowledged that many banks still lack a track record of assessing long-term risk-return profiles and foreclosing collateral in case of default. This is one of the reasons why the Banking Regulation insists on still applying a loan classification and provisioning scheme that is static and outdated by Western standards and discriminating against banks like BRE Bank, where historic default probability calculations across all industry sectors and modern risk management tools are in place already. The average quality of the banks' loan books deteriorated again this year, with classified loans (sub-standard, doubtful and loss) to the non-financial sector rising to 17% after the first six months, up from 15.3% in 2000 and 13.7% in 1999. These ratios put Poland in the middle field in the region together with Hungary.

Apart from the threat of poor quality in lending, one consequence of increased competition in the credit business is that most banking groups are focusing on asset gathering rather than extending credits. Taking deposits, selling mutual funds or other long-term investments and bancassurance products are all part of building a strong retail franchise that will provide a base for lending in the future.

There has been significant growth in retail banking. Total retail deposits of commercial banks grew to PLN 179.4bn in 2000 (up 15% compared to the previous year), accounting for 74% of total deposits to the non-financial sector. The main causes for the inflow are: growth in personal wealth, the "coming of age" of the baby-boom generation, a constant shift from "under the mattress" savings to the official banking system, and a gradual shift from cash to bank payments (for example, since 2000, social security payments are no longer payable in cash). In June 2001, the number of credit cards issued amounted to 12.4 million, up 10% from the end of 2000. There was also a substantial growth in ATM machines from 2000 in 1999 to 5300 at the end of 2000, and a parallel increase in the number of points of sale accepting credit cards.

The high level of banking activities conducted in foreign currencies is sometimes seen as a source of instability in the Polish market. In the first half of 2001, about 18% of banking sector deposits and 24.3% of credits were in foreign currencies. The growing instability of the zloty could put pressure on banks' balance sheets given the high level of such activity. Since the free flotation of the zloty in April 2000, banks' activity in the FX market has increased considerably. With the FX risk increasing, banks made greater use of forward and derivative instruments to hedge risk, and also to profit from potentially higher FX gains. This market, however, is dominated by only four banks, including BRE Bank. In the first half of 2000, total off-balance-sheet items at commercial banks grew 59% to PLN 1003.8bn, reflecting the banks' surge in derivative trading.

There is a strong trend towards electronic banking and modern distribution channels. Given the size of the country, Poland has learned from its own banks with widespread outlets as well as from Western European banks, that huge extensive branch networks with physical presence even in very remote areas can be very costly. And when the need arises to increase profitability, it is difficult to downscale them. Hence the natural way to solve the issue is the use of alternative distribution channels. A very good example is mBank, the first fully virtual bank in Poland and Central Europe, owned by BRE Bank. Currently it has 170,000 accounts after one year of operation and it is growing very fast. This being a challenge to both the newly established banks as well as for the older 'dinosaurs', all banks are forced to invest in modern infrastructure. And whether this has been achieved already or is in the process of being implemented, all banks in Poland will soon be equipped with modern and often state-of-the-art technology made to support further growth.

Poland different from the rest

It is worth mentioning that Poland started to reform the banking system even before political changes were underway by preparing for the establishment of a two-tier banking structure as early as 1988.

Today, Poland can certainly be regarded as one of the most advanced reformers of the banking sector, along with Hungary and the Baltic states. Not necessarily true for other – even financial industry – sectors, banking was subject to fast modernisation. Following a slowdown in the mid-90s, during the last four years bank privatisation in Poland has caught up to countries like Estonia, Latvia and Hungary in terms of the state's share in the banking system. One exception is of course the phenomenon witnessed both in Poland and Hungary of the treatment of the sensitive issue of restructuring and privatising large savings banks, to which the political class takes a sentimental liking in an effort to prevent these giants from falling prey to foreign capital. Efforts of the government to orchestrate consolidation of insolvent state-owned banks were only successful in preparing them for future development. Only when strategic partners (foreign and domestic) stepped in to provide capital and know-how transfer, product development, innovation, modernisation of risk management and IT, did the performance of these banks improve. Until then, many institutions were lacking financial fundamentals and were struggling with high administrative costs, overstaffing and low efficiency. At the moment, some of the major players among Polish banks are still subject to such essential changes and efforts. Those banks held up by internal restructuring, merger politics and struggling with bad portfolios inherited from the past, offer banks such as BRE Bank, that are well-managed, efficiently run, competitive and profitable for some time already, to gain their place among the top banks. This goes to show that 'big is beautiful' is not the only motto worth believing in.

Achievements can also be seen in the development of capital markets. Coming from a mono-bank system with no capital markets, the gradual development of a universal banking system led to a situation in which individuals kept their savings mainly in banks, which in turn were the primary source of external financing for the private sector. For some time banks will also remain the dominant investors in the equity and corporate debt markets (equity and debt market capitalization equal 42% of GDP in Poland, compared to 178% in Germany). By regional standards, Poland has by far the largest, best capitalized and liquid equity market. This achievement is due to the gradual and complete liberalization of foreign portfolio investment and high level of transparency by adopting and enforcing the latest Western standards for these markets. According to the EBRD's transition indicators for securities markets and non-bank financial institutions, Poland once again ranked highest in line with Hungary. Besides equity trading, the WSE has developed a sizeable bond market.

This leads to the point that Poland has very solid banking supervision, and on top of that a well-functioning stock-exchange supervision. Sometimes felt as a burden by some banks, it is largely due to prudent regulations and effective enforcement that Poland has never had a banking crisis during the transition period. This is in sharp contrast to some of the other emerging markets, where either timid regulation or loopholes and unpredictable enforcement practically asked for abuse. In general, quality and quantity of services and products has improved and is not far from Western standards. The retail banking industry is also fast developing with the most state-of-the-art technological channels available to clients. Non-bank financial intermediation is very advanced and offers banks additional fields of activity. All stock-listed banks have performance related salary schemes in place, most of them offering stock option schemes for their management.

Major driving forces in the advancement of Polish as well as all Eastern European banking will be the compliance with internal and external governance, increased competition – both domestic and international – and the compliance with partly new regulation and supervision. Even though the regulators are progressive in introducing new regulations to conform with EU and BIS requirements and some of the banks are in a position to comply, for some banks it remains a challenge in terms of technology and IT infrastructure to fulfill all requirements. This is certainly an issue in Poland, whereas more advanced countries like Estonia and Hungary have the benefit of smaller sized organisations and less regional dispersion.

Conclusion

To sum it up, Poland's banking system and financial sector is quite advanced compared to other countries in the region that have not even been mentioned here. Besides, there is no perfect financial markets model. Major differences exist even between the EU and the US, and regulations ensuring development and stability are continually subject to change. However, taking into consideration comparable indicators of Western financial markets, it is obvious that Poland still has to catch up. Nevertheless, it is on the right track and whether being an investor in Poland, a client to, or a strategic shareholder of a Polish bank, I can assure you that you can 'bank on banking in Poland'.

Banking on Eastern Europe

Alessandro Profumo

Many thanks, Mr. Chairman, Ladies and Gentlemen. It is a great opportunity for me to have the time here to share with you the experience of what we are doing in what we call New Europe. For us New Europe includes all the countries that are in process to access the EU, i.e. twelve countries in our view. Today we are already present in five of these countries and we also try to take advantage of opportunities in other countries.

First of all, why do we focus on this area? This is mainly do to the fact that in Italy we already achieved quite a good market share on one hand and return on equity (ROE) on the other hand. Today our ROE before tax is around 38 %, so it is almost impossible for us to create additional value for our shareholders saying that we will improve our efficiency by remaining where we are. So we have to identify other growth options. And we think that the Central European countries - or the New Europe as we call them - could represent for us a very good area in which we can create and already have created growth opportunities and generate value for our shareholders. This is mainly due to the fact that the expected growth in GDP is higher than in the Western countries and also all the banking figures are growing based on the GDP. So we have a double factor of growth in the area even as the level of risk is clearly declining. For sure, today we still have a higher risk in the area, the credit risk and also market risk which is higher than in the Western countries or in Italy. For instance, I give to you two numbers: today the gross non-performing loans on total loans in Italy for our group is around 2.8 %, in the area for our group it is 9.3 %. It is clear that the risk is still higher, but we are sure that the risk is declining and with the accession to the EU this risk will decline even more.

So we decided to go into the area. And what is the strategy that we have? First of all the strategy is to identify which other countries we should enter. We want to be present in these countries not as a small player. We want to really be a domestic player with a market share which on an optimistic basis could be between 15 to 20 per cent. We are already there in both Poland and Bulgaria. We are trying to improve our presence in Croatia, we are present in Slovakia. The only area in which the strategy is different is Romania, where we have bought a small bank. Today the strategy we have in Romania is to serve our own customers which are present in the area. There are more or less 10,000 Italian corporates already active in Romania. So the target is very clear. We want to have a return on investment (ROI) of around 18 % three years after we invest in a country. To give you an example: today in Poland we already have a return on investment of around 14 %. So we can say that the experience we are having in Poland is really quite positive.

How are we present in the area? We are applying the same models that we have in Italy. That means the federal model where we have strong control by the holding company. The MIS system is always the same, the incentive system is always the same, the way we measure risk is always the same – but we grant a lot of independence for the commercial point of view to the staff, to the people we have in the area. This for us is fundamental because it is crystal clear that being based in Milan, it is impossible for us to even understand the Northeast of Italy market, and it is completely impossible to understand what is going on in Poland, in Croatia, in Slovakia, in Bulgaria and so on. So we apply exactly the same model where we foster a strong independence from the commercial point of view but definitely try to get all the synergies from the production side. This is the reason why today our cost-income ratio at the group level is around 52 %, meaning we have been able to achieve a very good efficiency level. We are trying to apply exactly the same model. So the restructuring process that we apply in the countries where we are present is more or less always the same and is based on three major periods. The first period, we call the first 100 days, is the early stage in which we usually do a management assessment with an external company. This helps us understand the high potentials within the management team how the management team is composed, if we have to insert specific people, and how together we can manage the company. Then we redefine the organisation of the bank and define with the new management team immediately a new three-year-plan, because, certainly, we have an investment plan. Usually the bank has its own strategic plan, but it is important to merge these two plans to share the value system and the goals. And we put in place the first task forces. We work quite a lot through a task force system. First we identify the problems, with the task force composed of local people and by colleagues who can be Italian or not, but who have experience in the field of restructuring with very specific tasks, time-schedule, products and so on. Just to give you an idea: in these five countries where we started there are still some task forces functioning, more than 70 different task forces with specific duties. The second phase is usually a stimulation programme. So the first thing we do is that we run faster than before to achieve results, also without huge organisational and IT changes. We insert new products which can be utilised in these different countries.

We usually always have a crash programme on credit risk process and increased selectivity. Because this is usually the main risk that we have in the area, we have to start to manage the credit process in a different way, without having a new IT system that can help later in credit selection. We also reorganise the branch network, usually trying to organise by customer segment as we did in Italy in a very successful way, and as we are doing already in Poland and Bulgaria. In Croatia and Slovakia there is a little delay in this process. And we redefine the budgeting, reporting and the annual report system. The chairman of the supervisory board of Bank Pekao usually spends two days in Warsaw every month, and when I arrive there I see immediately the figures of the banks exactly in the same way as I read the numbers in the bank in Milan and for the other banks of the group. So I can immediately understand what is going on to be much more effective in terms of redefining the direction of the bank.

The third phase is longer as it usually takes two years to redesign completely the credit system. This is always the main focus on which we are working. We always had a lot of problems in the IT area. The cost-cutting process is fundamental. We start always in the first days to be honest with cost-cutting, and we can say that we are using many of the same suppliers that are used in other parts of the group. For sure, there many other areas in which we are working, for example the divestiture of non-banking assets, because usually these banks have a lot of old things which are not part of the core business. And at the end, a full divisionalisation of the bank. As I said before, the results that we achieved are already quite good. Today we are the second largest player in the area in terms of total assets controlled. We are by far the most profitable one in the area. As I said, the return on investment for Bank Pekao is around 14 % now, and is already 10 % ROI for the other banks that we acquired in the year 2000. So we are really happy with this initiative and we are still focusing on growing in the area. Many thanks.

Banking on Eastern Europe

Josef Tošovský

INTRODUCTION

In its perpetual struggle with politics, economics scored an important victory in the late 1990s: the banking industry in Central and Eastern Europe. Even ahead of formal EU membership for countries in the region, banks in Central and Eastern Europe have become largely owned by banks from the EU and are integrated in the European financial system. Twelve years ago, when the transition began, few people would have anticipated this outcome. In the early days, it was not clear what the best solutions for financial sector reforms were. Politics dominated and slowed down bolder reforms. But changes in the banking industry worldwide swept aside political concerns in the mid-1990s. Following long dormancy under central planning, the banking industry in the region began a rapid process of deregulation, privatisation and opening up to foreign competition, and is currently going through a market-driven consolidation process. And while some politicians still debate the costs and benefits of EU membership, banks in Central and Eastern Europe no longer have doubts where their future belongs.

EARLY REFORMS

The banking industry in Central and Eastern Europe has made enormous progress over the past decade. Before 1990, banking and financial systems in the region were rudimentary. The monobank system was still dominant: the central bank was essentially administering the credit and cash plans for the economy, and commercial banking functions were usually limited to the foreign trade bank and the savings banks. Most other “banks” were specialised financial institutions, channelling credit to state-owned enterprises in line with the government’s credit plan. A two-tier banking system was in place only in the former Yugoslavia and Hungary, but even there almost all banks were state-owned and the government controlled the credit and money markets. Commercial banking legislation and bank supervision barely existed, and the institution of bankruptcy was virtually unknown, given that the ultimate owner of both the enterprises and the banks was the state. Since credit allocation typically did not follow strict commercial criteria, much of the inherited stock of bank credit was potentially bad. Given this background, initial reforms were aimed at creating the basic institutional framework for monetary management, commercial banking, bank supervision, and payment and settlement systems. But even at this early stage, policy makers had to grapple with issues that would preoccupy them in the years to come: how best to liberalise financial markets, how to open up to foreign competition, and what ownership structure to aim for in the banking industry. These were daunting tasks, especially considering the lack of regulatory, supervisory and commercial banking skills. There were also pressing macroeconomic concerns, as existing banks had to be recapitalised, the stock of inherited bad debt resolved, and new loans extended on a sound commercial basis in order to harden budget constraints and eliminate a potential source of inflation.

In such circumstances, simple and well-tried solutions were often not available. Policy makers had to devise new reform approaches. For example, it was necessary to write off much of the inherited bank credits, while emphasising the one-off nature of this operation to minimise moral hazard. As financial markets and the legal infrastructure were too weak to exert effective discipline, the privatisation of the large state-owned commercial banks could not be immediately considered. At the same time, it was recognised that banking services to new private enterprises could be more efficiently provided by new bank entrants than by the existing state-owned banks, many of which were not interested in this segment of the market. Many countries in the region thus adopted liberal licensing rules in an effort to promote competition, speed up the development of financial markets, and put some pressure on the large state-owned commercial banks. There was strong political resistance to foreign banks when they began showing interest in the region. It was widely believed that one should not sell the “family silver” to foreign owners, that domestic savings might be used to fund projects in other countries, and that foreign banks would be buying local banks at a discount after the taxpayers’ money had been used to clean up the banks’ balance sheets.

CHANGING COURSE IN THE MID-1990s

Meanwhile, far-reaching changes were taking place in the banking industry worldwide. When the transition was just starting, banking in most emerging economies was still a highly protected industry, living off good spreads achieved on regulated deposit and lending rates, and pervasive restrictions on domestic and foreign entry. But global market and technology developments, macroeconomic pressures and banking crises in the 1990s forced the banking industry and the regulators to change the old way of doing business, to deregulate the industry at the national level, and open up financial markets to foreign competition. As a result, borders between financial products, banks and non-bank financial institutions, and the geographical locations of financial institutions have started to break down. These changes have significantly increased competitive pressures on banks in the emerging economies and have led to significant changes in the structure of the banking industry worldwide.

Changes in the international banking landscape and the mixed experience with reforms from the first half of the nineties – including some costly bail-outs of the state-owned banks and bankruptcies of many small private banks – have led the policy makers to reconsider the course of reforms in the mid-1990s. It became clear that, to enhance competition and efficiency in the banking sector and strengthen its capital base, half-hearted reforms were no longer an option. The privatisation of large banks had become the sine qua non of bank reforms. This could not be done without foreign participation. Protectionist arguments had to be eschewed. Politics had to give way to economics.

One after another, countries in Central and Eastern Europe thus shifted the strategy of bank reform toward the privatisation of domestic banks, mainly through foreign strategic partners, while continuing to strengthen the supervisory framework and build the financial market infrastructure. Most bank sales were conducted through open competitive bidding processes to ensure transparency in the divestiture of the government's equity holdings. Some privatisations through the sale of shares on the local stock exchanges were also successful (Hungary's OTP Bank is one example). But this method could not be applied to the majority of state-owned banks given the lack of solid bank governance and experienced management teams. Despite some difficulties, including the treatment of hidden liabilities (for which foreign buyers in many countries exacted some form of guarantee), this approach has been by and large successful.

CONSOLIDATION AND INCREASING COMPETITION IN THE LATE 1990s

Privatisation and foreign bank entry did not mark the end of bank reforms. In the late 1990s, a wave of mergers and consolidation started in the banking industry outside of Central and Eastern Europe. Deregulation measures reduced sources of cheap funding for many banks, forced them to price risks more realistically, and put pressure on their profits. Banks were also exposed to increased competition from the non-bank financial industry. Greater emphasis on capital adequacy was a further spur to mergers, as many banks faced difficulty raising new capital to meet the higher standards.

Given the large presence of foreign banks, these developments were bound to influence the banking industry in Central and Eastern Europe. Indeed, mergers between parent banks in EU countries are increasingly a factor behind bank mergers in central Europe. But there were also domestic reasons for consolidation. Larger countries in the region still had between 20 and 70 commercial banks each, and individual banks were relatively small. Most countries had no dominant bank in the corporate sector, and usually one large retail bank with a market share of 20–25%. Moreover, building a new branch network was very costly. In this environment, both local and foreign institutions had incentives to engage in mergers and acquisitions. As in industrial countries, these activities aimed at exploiting economies of scale and scope, improving organisational efficiency and achieving a greater market share – some foreign banks consider a 15% market share as a minimum for profitable operation. Although the authorities sometimes promote mergers to strengthen domestic banks or to restructure ailing banks, especially ahead of privatisation, bank consolidation in the region has been by and large market driven. This is a relatively new phenomenon in the emerging economies, where most mergers in the past have resulted from government-led efforts to restructure inefficient banking systems (as in many Latin American countries) or from intervention following banking crises (as in Korea and Southeast Asia).

Privatisation, foreign bank entry, consolidation, and improvements in institutional framework and financial market infrastructure have resulted in deep structural changes in the banking industry in Central and Eastern Europe. After the initial boom, the number of banking institutions declined sharply in the second half of the 1990s. Even more significant has been the shift in the shareholder structure from the predominantly domestic and state-owned institutions to almost entirely private and foreign-owned institutions. By the middle of 2001, the share of foreign bank ownership in banking system assets has risen to 60–80% in most countries (one notable exception is Slovenia), with shares of over 90% in some Baltic states and the Czech Republic. More fundamentally, the strengthening of prudential regulations and bank supervision, and improved bank governance brought about by privatisation and sales to foreign strategic investors have improved asset quality, bank performance and the efficiency of financial intermediation in recent years. The major developments were as follows:

- The share of lending to the government is declining, and lending to households is rising rapidly. In the Czech Republic, Hungary, Poland and Slovenia, there are signs that lending to small and medium-sized enterprises (SMEs) is growing rapidly, often under competitive pressure within the banking industry. It should be noted, however, that loans to SMEs are often extended against guarantees of their foreign production and trading partners. In other economies in the region, SMEs are largely cut off from bank credit and have to finance their operations with internal funds or rely on special government programmes.

- In the Czech Republic, Estonia, Hungary, Poland and Slovakia, the spreads between short-term deposit and lending rates, as well as between interbank market and lending rates, are already at (or below) the spreads in Austria, Germany, France and Italy. Intermediation margins have also declined in Bulgaria, Croatia and Latvia. However, despite large inroads made by foreign banks, the spreads in these countries remain higher than in western Europe. This could well be because of greater credit risk. It could also reflect attempts by foreign owners to recover the costs of restructuring, as, even after the state cleaned up the banks' balance sheets, foreign owners had to invest heavily in technology and the internal reorganisation of banks they acquired. In other countries, there are indications that the margins remain high because of the lack of effective competition, especially at the retail level.

- Improvements in asset quality and several prudential indicators now suggest the better health of banking systems. Compared with industrial countries, non-performing loans are still very high – over 14% of total loans on average at the end of 2000. This has partly reflected constraints in legislation (often motivated by tax revenue considerations), which does not allow banks in some countries to write off bad loans quickly. Reflecting the high share of non-performing loans, the levels of provisions for loan losses were raised considerably in most countries.

- Capital adequacy ratios have also improved, especially in countries with more vulnerable banking systems in the recent past (Bulgaria, Croatia, Romania). In the Baltic states and Hungary, banking supervision was strengthened even before foreign banks took over ownership of much of the banking system. As a result, the need to maintain very high capital ratios has diminished and capital ratios declined slightly.

- Trends in bank profitability are mixed and are difficult to interpret, as banking systems in some countries that report high rates of return on assets or very high capital still have a relatively high share of non-performing loans.

It should not be forgotten that improvements in the banking sector have come at a very high price for many countries in the region. The total costs of bank restructuring and deposit compensation in most countries exceeded 10% of GDP.

AT THE THRESHOLD OF EU ENTRY

The long-term, painful restructuring of the banking industry in Central and Eastern Europe has been essentially completed. Most bank privatisations in the region have also been completed. The banking systems of most EU candidate countries today are strongly intertwined with the EU. The prominent role played in the region by western European banks has already led to consolidation and integration of the banking industry into the common market of the EU. The adoption of stricter legislation, regulations and supervision conforming with EU standards – including higher capital requirements – will remain a powerful catalyst for bank consolidation in the region.

In the corporate sector, the development of local financial markets has gone hand in hand with the inflow of foreign capital and the ongoing micro-level integration into the EU. Foreign investment in the banking sector has not only helped to develop the domestic financial sectors, but has also created a favourable business environment for further foreign capital inflows. Finally, development of non-bank financial intermediaries and gradual removal of the remaining capital controls is providing further impetus for financial integration by expanding the range of investment opportunities to individual and institutional investors in Central and Eastern Europe. In terms of convergence and integration of the banking sectors, economics is clearly leading politics.

The Euro Goes East

Rolf-E. Breuer

Ladies and Gentlemen:
It is one of the most difficult things to get back to work after lunch and the second difficult thing to keep one's listeners awake. Hopefully the panel will successfully do both; at least the first task seems to be achieved now. This is the third panel of today's congress and the session is labelled “The Euro Goes East”. For the sake of the panellists who were not here yet, the first session dealt with the political and macroeconomic implications and ramifications of Europe going East, meaning EU enlargement. Then we had a session on banking in Eastern Europe in the wake of the upcoming enlargement. And now our panel will deal with the currency, the euro itself, going East. Some people could argue that is still too far away, so why do you discuss it? I think that is too superficial. I would like to share three observations with you suggesting that the euro going East is closer than we think.

The first observation is that future participation in EMU is part of the acquis communautaire and therefore it is a consequence of joining EU. So it is expected that candidate countries for the EU become full members of EMU once they have joined the EU. We should talk about meeting the convergence criteria in time without sacrificing growth and that, of course, requires long-term strategies. We will discuss what kind of strategies might be the right ones.

The second observation in this context is that there are some countries in the East which are de facto already members of the euro club, for instance Estonia with a currency board. We have to discuss the controversial issue of “euroisation”, i.e. the introduction of the euro without complying to the rules of the EU Treaty and fulfilling the convergence criteria. “Euroisation” seems to provide some sort of a short-cut to the euro for countries not willing to go through the regular prescribed process of joining EMU. We know very well that not everybody here approves of eurorisation.

The third observation is that we will see the euro going East already on January 1st 2002, namely in the form of coins and notes. As we know, there are a lot of Deutschmarks in eastern Europe in "piggy banks", as so-called "mattress money", or wherever people keep the personal cash reserves. So the question in this context is a very interesting one: what happens with that money and will it just be changed into euro coins and notes and meet with the same fate as the former Deutschmark personal reserves, the black-market money or whatever. So that means the euro going East starts in less than forty days.

Now, the envisaged EMU membership of EU accession countries is accompanied by a lot of expectations on the one hand and concerns on the other. For one, there is a rather superficial argument in the world, specifically here in Germany, which says that enlargement could potentially contribute to the weakness of the euro rather than to its strength and that part of the present external weakness of the euro is due to the expectation of candidate countries joining EU and later on EMU and adding volatility to the currency. We have to discuss that even though my personal feeling is that this is a terrible prejudice. We have to talk about the famous convergence criteria and we must discuss whether those convergence criteria should be handled as strictly as in the selection of the first-round EMU member states. We have to keep in mind that the economic situations and structures of the candidate countries are extremely different compared with the current member states. Just take per-capita income which in the case of Bulgaria is one-fifth, and in the case of Cyprus four-fifths of the EU average. It shows that the candidates start from extremely different situations. And then real convergence. We heard this morning from the Swedish Minister of Foreign Affairs, Anna Lindh, about the bumpy road to the euro. Indeed, there are a lot of problems to solve. I hope the panel will discuss some of those difficult issues.

The Euro Goes East

Willem Duisenberg

Ladies and Gentlemen,
Let me first thank the organisers of this Frankfurt European Banking Congress for giving me the opportunity to address such a distinguished audience. Today I would like to share with you a few thoughts about the process of EU accession from a central banker's perspective, and review some of the issues that are of particular relevance to the ECB.

Little more than ten years after the beginning of the transition to market economies in Central and Eastern European countries, the successful model of European integration is in the process of being extended. This testifies to the attractiveness of the European Union as a sound framework providing both political stability and economic progress. In a few weeks' time, on 1 January 2002, a new milestone will be reached when the euro, our money, becomes truly tangible. The introduction of the euro banknotes and coins indeed constitutes a historic event in the process of European integration, and represents a key accomplishment in the already long European experience. The changeover comes as we approach a situation in which inflation should fall below 2% and price stability should be restored. In line with our forward-looking strategy we have cut interest rates on the basis of reduced risks to price stability. Recent data are in line with expectations and confirm our decision of 8 November which took account of all relevant information.

As President of the ECB, I would like to confirm that the euro will indeed eventually “go east”. As many as 12 countries from central, eastern and southern Europe and the Mediterranean are currently negotiating accession to the EU. They have made remarkable progress, both in negotiations and in strengthening their economies and policy-relevant institutions. However, the road towards EU membership and, later, the adoption of the euro still poses a number of significant challenges.

What are these challenges? Let me focus briefly on three economic areas in which notable differences still prevail between accession countries and EU Member States: first, real convergence, second, nominal convergence and, finally, the structure and functioning of the financial sector.

By "real convergence", I mean the broad adjustment through structural reforms and economic development of the economies towards structures prevailing in the EU. This requires, inter alia, the completion of the market economy transition agenda, further privatisation in some sectors, and the strengthening of the institutional and legal framework. Real convergence is seen as facilitating economic cohesion among Member States once they have joined EMU, thereby helping to minimise the risk and effects of asymmetric shocks. Hence, in order to enhance the process of real convergence as much as possible, accession countries should ensure that they make progress in the restructuring of their economies and gradually align them with those of the euro area. Real convergence is often interpreted as a catching-up in real income with the EU. Such a narrow measure is, however, only a rough proxy for the concept of real convergence I was referring to. Indeed, different income levels can be compatible with Monetary Union, as we know from our own experience in the euro area.

As for nominal convergence, accession countries have achieved a remarkable process of disinflation during the last decade. Inflation is expected to reach around 6% on average by the end of this year. Nevertheless, further progress on disinflation might turn out to be more complicated in the coming years. First, several macroeconomic and microeconomic factors as well as transition-related factors will continue to push up inflation in many accession countries. Second, what is known as the "Balassa-Samuelson effect", that is, the potential inflationary pressures arising from higher productivity growth in catching-up economies, has also been held responsible for higher inflation in accession countries. However, research has shown that this effect should not be overestimated. These factors should be borne in mind when designing monetary policy strategies. In this context, disinflation in accession countries should be promoted, at a pace determined by the overall economic situation and in particular by the need for these countries to foster real convergence. In addition, the Maastricht inflation criterion should not be regarded as an immediate requirement, but rather as a medium-term objective for the central banks of the accession countries. This should not mean, however, that accession countries do not have to pay attention to progress in nominal convergence. On the contrary, a balanced monetary and fiscal policy stance and wage increases supported by productivity gains should favour the disinflation process of accession countries, and allow them to make progress on nominal and real convergence in parallel.

As a specific topic that is of great relevance to the ECB in the accession process, I would like to mention the structure and functioning of the accession countries' financial sector. Significant progress has been made in restructuring and consolidating the banking sector over the past few years. This progress has been achieved through the large-scale privatisation of state-owned banks and the extensive opening-up of the banking sector to foreign ownership. This process has contributed to greater financial integration with the EU and significant gains in terms of efficiency and stability. However, the level of financial intermediation remains relatively low and the provision of bank financing represents a much smaller share of GDP in the accession countries than in the euro area countries. Furthermore, the financial sector of accession countries remains dominated by the banking industry, as capital markets are not yet fully developed. From an ECB perspective, further deepening of the accession countries' financial markets is needed to ensure the proper transmission of monetary policy impulses once they join the euro area, and it may also help these countries make full use of their growth potential.

Coping with any of the three challenges which I have just mentioned will have a significant impact on the design of monetary and exchange rate policies. Taking into account the different starting points and progress made so far in addressing these challenges, accession countries may well pursue different approaches in the pre-accession phase. Once in the EU, however, there is a clear path defined in the Treaty that should be followed by all EU Member States towards the adoption of the euro.

First, immediately upon EU accession, the new Member States have to treat their exchange rate policy as a matter of common interest. Furthermore, in view of the final objective of adopting the euro, accession countries are expected to join ERM II at some point following accession to the EU.

Most accession countries have already expressed their intention to join the mechanism as soon as possible after their entry into the EU. However, it should be clear that ERM II membership does not need to happen immediately after EU accession in all cases, nor does ERM II membership need to be limited to only two years, which is the minimum for adoption of the euro. A longer membership of ERM II may, in some cases, be helpful since it would allow countries to retain the exchange rate as an instrumental policy variable during the catching-up process. Participation in ERM II should thus be seen as a meaningful and flexible framework for increasing convergence with the euro area, and for tackling the challenges faced by accession countries on the road towards the adoption of the euro.

Finally, after having outlined the path along which the euro will go east, I would also like to say a few words about a path which I am confident will not be followed – and that is unilateral euroisation. Such an adoption of the euro outside the Treaty process would not be welcome as it would run counter to the important process of convergence prior to the adoption of the euro outlined in the Treaty. Unilateral euroisation would also imply circumventing the process of multilateral assessment of new members by current EU Member States and as such would be difficult to reconcile with the co-operative spirit of a community of fellow members. From the other perspective, I believe it would also not be in the interest of accession countries, as it would imply relinquishing monetary and exchange rate policy instruments at a very early stage of convergence for these economies. It would further deprive the countries concerned of a lender of last resort function and non-negligible seignorage revenues. Finally, it would make the integration of the central banks concerned into the Eurosystem operational framework much more difficult, if not impossible.

Ladies and Gentlemen, I should like to end my remarks here by saying that the Eurosystem is fully aware of the future implications of the ongoing accession process for the fulfilment of its own statutory objectives. As the historic process of reunifying Europe unfolds before our eyes, let me assure you that the ECB is ready and looking forward to playing its part.

Thank you very much for your attention.

The Euro Goes East

Leszek Balcerowicz

Thank you very much Mr. Chairman,
I welcome this opportunity to address such a distinguished audience.

I would like to start with two basic assumptions. First, we are not discussing whether the euro will go east or not, because we are assuming Poland and other candidate countries will enter the European Union with the status of a country with derogation, so sooner or later they will be obliged to join the Monetary Union as well. Therefore, the issue under discussion is not “if”, but “when” and “how” i.e. what is the optimal timing and the optimal path.

Secondly, one should assume equal treatment of candidates and present EU member countries i.e. fulfilling the Maastrich Criteria, no less no more. There should be no additional criteria like, for example, a required level of financial deepening, as it would indicate an unequal treatment of candidate countries.

Taking the second assumption of the entry into the EMU as granted, I would like to focus on the core issue, which is the question of optimal timing.

My basic point is, that, firstly, early entry into the Monetary Union is possible and secondly, that it is preferable to the delayed one. By early entry I mean entry close to the earliest possible date, which one can recognise to be around year 2006, given the assumption of entry to the European Union in 2004. It is this time neighbourhood we need to consider. The points would be as follows.

First of all, let me say, that, in my opinion, arguments applicable to Poland are also largely true for other candidate countries in most of the cases.

Poland has achieved a relatively high level of structural convergence with the European Union. It can be measured, for example, by a share of exports to the EU in relation to all exports. This number is actually higher in Poland right now than it had been in Greece, Portugal and Spain before their respective entries to the EU and the MU. We have also achieved a high degree of cyclical convergence. These two points combined, translate to a situation in which Poland is not so sensitive any more to, what is called, an asymmetric shock.

Second, we have achieved a tremendous extent of disinflation. Inflation in Poland this year would be between 4% and 5% and similar figures will apply to other candidate countries. If one compares this data with inflation rates in some of the EU countries, one cannot see much of a difference – look at the Netherlands.

Third, Poland had managed to achieve a high level of disinflation while introducing a high level of price liberalization. It means there is only a limited scope for further corrective inflation. All but few prices are completely liberalized and driven by healthy market conditions.

Fourth, in respect to the so-called Balassa-Samuelson Effect, I agree with President Duisenberg, that it is mostly an empirical issue. I think the extent of this effect has been overstated and overdone in many theoretical studies. Empirical data in respect to Poland has shown, that in the past the contribution of the BS-Effect to the overall inflation rate has been in the range from 1% to 1.5%.

As a matter of fact, the BS-Effect is also present in the Eurozone, in countries like Greece and Portugal. This is not the reason for, as some people heralded, a weak euro. Problems of Greece are not responsible for a weak euro that is, if one thinks the euro is weak.

The already mentioned disinflation, the limited scope for future corrective inflation, and the manageable level of the BS-Effect make the Maastricht Inflation criteria achievable. Fiscal criteria must be met in the interest of the countries concerned, as it would contribute to their economic growth.

Fifth, there is an intermediate period between the date of entry of Poland and other candidate countries into the European Union and membership of the Monetary Union. The question is, what is the optimal length of this period? I would like to point out, that it might be a rather turbulent time. Economic forces behind convergence and rapid capital flows might create an economic roller-coaster. It may well be in the interest of the candidate countries to make this period as short as possible.

Sixth, it is true that any country entering the EMU need to fix the exchange rate. One should not take for granted, however, that the longer the period of the intermediate regime the better, as it is not always true that a longer waiting produces more information about the proper rate of exchange. It may produce just more noise.

Seventh, both further efficient disinflation and strengthening long-term economic growth require completion of certain structural reforms in the candidate countries. There is no way around it. In the case of Poland, the liberalization of the labour market and an increased participation rate is badly needed. Fiscal reforms must concentrate on rationalising the spending and not just increasing taxes. Privatisation needs to be completed and it should include the banking sector. We have to strengthen competition in fuel and energy sectors. The legal framework needs to be adjusted to be more efficient.

The earlier deadline of the entry to the EU could act as a powerful motivating device to complete those reforms. I am a great believer in deadlines and I think they help to achieve success. Delaying the entry could do more harm than good, as it could weaken the incentive to complete the necessary and often politically costly reforms.

Eighth, flexibility of the rate of exchange is a poor substitute for structural reforms.

Ninth, I agree there is evident fear among certain existing EU members, including Germany, that once Poland, Hungary, Slovakia or Latvia enter the EMU, the euro could weaken. I do not find any rational argument supporting this proposition.

Firstly, as I pointed out, an earlier date of entry would mobilise the candidate countries to complete the structural reforms.

Secondly, candidate countries combined make up for only around 6% of the enlarged EU GDP. Any negative impact the enlargement might have, which is unlikely, will in any case be highly subdued.

Thirdly, I think the reason behind the relative weakness of the euro, is not Greece or Portugal or the other EMU members but something different. The entry of Poland and other countries into the EMU, assuming they complete reforms, will not weaken the euro at all. Finally, as for today there are differences in the rate of inflation given the BS-Effect in the EMU countries, hence why should there be a problem for others, with inflation only marginally different from the EU average, to join the Eurozone?

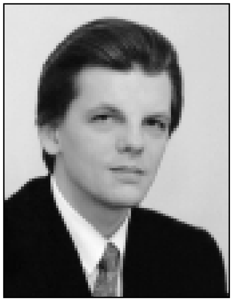
Tenth, the earlier entry of the candidate countries into EMU would allow them to start reaping the related advantages (more price transparency, reduced transformation costs, stronger macroeconomic framework) at an earlier date.

Summarising, we should not oppose nominal and real convergence. One should not assume there is an unavoidable conflict between the two. Firstly, results of nominal convergence, a low inflation rate among them, are one of the foundations of the long-term economic growth. Secondly, the great harmoniser between the real and nominal convergence are the structural reforms. The more reforms one has implemented, the less costly disinflation is and the stronger the longer term economic growth.

I would finish up with the main point. The strategy on behalf of the European Union should not be to delay the entry of the candidate countries into EMU but to encourage the candidates to complete structural reforms. The cost of disinflation would be lowered and the long term economic perspective would be helped. This is a win-win strategy as it helps the candidates and ensures the existing EU members that the new members would be economically stable and dynamic.

Thank you very much.

The Euro Goes East



Einars Repše

Ladies and Gentlemen,

After the Treaty of Nice and the Gothenburg Summit, it is clear that the enlargement of the European Union is only a matter of time. Given the current institutional framework, this also means that all new member countries will join the Economic and Monetary Union in due time. Therefore, it is only natural that the question should arise, both among policymakers and the public: what effect the emergence of the euro has had and is likely to have on these countries? Along with answering this question in respect of my country, I would also like to explain why Latvia, somewhat at odds with the general trend, has not changed its currency peg to the euro but still has the SDR basket as its foreign exchange anchor.

Due to the size of the Eurozone market and its importance for the rest of Europe, every country on the continent is affected by the creation of the single currency – through both trade and financial channels. For accession countries, including Latvia, the introduction of the euro has some additional and very important implications.

The most important feature of Latvian foreign trade has been its reorientation towards the European Union. The share of the EU in Latvia's total foreign trade turnover has increased from 30% in 1993 to almost 60% in 2000. Given this remarkable shift in the trade pattern, one would certainly expect a parallel increase in the use of the euro in foreign trade transactions. However, Latvia's trade with the Eurozone countries accounts only for 36% of its total trade turnover. This difference is due to the fact that the United Kingdom, Denmark and Sweden are all among Latvia's largest trade partners. The currency composition of foreign trade indicates that the share of the euro in our currency structure, amounting to 36%, mirrors the share of the Eurozone countries in our foreign trade turnover. It is obvious that the euro is currently used only for trade transactions with the Eurozone, whereas trade with our other partners, including those EU members that have opted-out of the single currency, is conducted in their national currencies, or in dollars.

The Bank of Latvia does not intend to either encourage or discourage the use of any particular currency. Instead, we believe that developments in this area are a reliable indicator of the market sentiment with respect to specific currencies, and we monitor them closely.

As regards the financial effects, in Latvia these are in line with the global trends. The government has been active in using the euro as international finance currency. Over the past year, the government twice issued euro-denominated bonds of a five-year maturity, and both issues were a success. As a result, the composition of the government's external debt has shifted in favour of the euro – from less than 30% of total external debt in euro-currencies in 1998, to over 60% in 2001.

The private sector in Latvia has been less active in using the euro in self-financing. Thus, for instance, the share of the euro in the banking sector's external debt has risen from the 20% average before 1999 to slightly over 30% in 2000. Here the dollar still plays a prominent role, accounting for 60% of total debt. A similar picture can be observed in the enterprise sector, where the share of the euro in the external debt has remained broadly unchanged at 25%.

The structure of foreign currency deposits in Latvia likewise does not reveal a significant shift towards the euro in the past couple of years. In fact, the euro, including the individual euro currencies, accounts for only 10% of all foreign currency deposits, while the remaining 90% are denominated almost exclusively in dollars. This has remained unchanged since the mid-nineties, and the introduction of the euro has not had any significant effect. We can only assume that the structure of foreign cash holdings of residents is broadly similar. If the Latvian public decide to hold foreign currency as a store of value, they choose the dollar in nine cases out of ten. It remains to be seen whether there is any significant change in this pattern once the euro starts circulating as cash.

In our opinion, the immediate or short-term effects of the introduction of the Euro are and will be rather limited in Latvia. The long-term impact of Latvia's overall efforts to join the EU, which will bring about the need to comply with the criteria for joining the Monetary Union, is much more obvious. Although it is often stressed that Maastricht criteria have been intended for EU economies only and do not apply to pre-accession countries, the principles behind the figures serve as useful guidelines for sound economic policies already at the present stage.

For that reason, we in Latvia have set fulfilling Maastricht convergence criteria as our medium-term target, and will be able to meet them when we have to. Our public debt is already much lower than the Maastricht ceiling, our budget deficit has always been below the 3% level (except in 1999, when the deficit increased temporarily to cushion the external shock that hit the economy in 1998). Inflation, for the last two years running, has been below 3%, and the peg to the SDR is evidence for our commitment to currency stability. Thus, both the introduction of the euro and the emergence of the policy framework associated with it have had a positive effect on the formulation and implementation of Latvia's economic policies.

To summarize, the introduction of the euro has been exerting certain impact on our economy, and we expect that the magnitude of this impact is likely to grow in the coming years. It does not mean, however, that we have to change our current exchange rate regime immediately. We are confident that the SDR basket is, at the moment, the most appropriate exchange rate anchor for Latvia. The situation may and certainly will change over time, as the euro strengthens its status as an international currency. Let me outline some of these future changes.

First, we can reasonably assume that the euro will be in higher demand throughout the countries of Central and Eastern Europe, including Latvia, after it turns into a tangible currency in January 2002. Moreover, the use of the euro may gradually increase in foreign trade settlements with Latvia's trading partners in the East. And finally, given Latvia's current trade pattern, the use of the euro in its foreign trade transactions is likely to be greatly enhanced if and when the three “non-euro countries” of the EU decide to join the Eurozone.

Yet it is very difficult to predict the exact course of development these trends will follow. In line with the very nature of central banking, we have to be conservative and act on the cautious assumption that the use of the euro in Latvia will expand gradually, rather than rapidly. Accordingly, the Bank of Latvia has repeatedly stated that the current peg to the SDR basket will be preserved until Latvia joins the EU. In due time after its EU accession and fulfilment of the Maastricht criteria, Latvia will adopt the euro as its national currency.

The current topic of debate in this area has been the extent to which real and nominal convergence should be pursued simultaneously. Achieving high economic growth to narrow the income gap between Latvia and the EU is not a statutory objective of the Bank of Latvia. However, we may consider whether policies pursued by the central bank have had any impact on real convergence: for instance, has the exchange rate regime facilitated the appreciation of the real exchange rate necessary for catching up?

As a country open to foreign trade and thus dependent on it, Latvia has by and large achieved price convergence in the group of internationally traded goods. The fixed nominal exchange rate keeps the prices of tradables stable and thus helps Latvian exporters to compete in the international market. Meanwhile, the already very moderate real exchange rate appreciation stems from the rising prices of nontradables. The alternative would be to aim for even lower overall inflation at the expense of nominal appreciation. However, due to the possible adverse effects on the external sector this option is not viable. Therefore we consider our fixed exchange rate strategy optimal for Latvia and will not change the peg until our accession to the EU.

Economic data support our policies. Since the mid-nineties, growth rate in Latvia has been well above the EU average. This year, Latvia will probably be the most rapidly developing accession country, with GDP growth over 7%. Remarkably, the very high GDP growth for a second year in a row has been achieved in a low inflation environment.

It is evident that Latvia has benefited from its fixed exchange rate regime. The Bank of Latvia has been able to sustain the current peg for more than seven years and, in due time, will be equally committed to the new exchange rate peg under the ERM-2.

Thank you for your attention.

The Euro Goes East

Brigita Schmögnerová

Thank you. This is actually quite a unique opportunity for me to sit among central bankers. Before we started this panel the President of the ECB told me that, there is not necessarily a tension between finance ministers and central bankers and that the central banker is usually a supporter of the finance minister in the cabinet, and I have to say that he is right. But we also have sometimes different views, but this is life. I would also like to take the benefit from the fact that I am the last speaker and if you allow me I would like to make just a few comments to all of what has been said.

The first one was about meeting the criteria, that we should meet them without sacrificing growth. I think that this is really extremely important and it does not matter whether income convergence is measured only by growth convergence or not. I think growth is still one of the most important criteria for catching up. As Commissioner Verheugen said a few hours ago, the European Commission recently released the progress reports, i.e. the regular reports on progress of the applicant countries towards accession. The progress reports evaluate each country on the basis of a list of criteria, including political, as well as economic criteria. Not only the “Maastricht criteria” which is, as everybody knows, not a precondition to EU accession. But in any case I think that it is important to understand that one of the most important case tests is really growth convergence or income convergence. This is I think important also from the political point of view, because if you really want to acquire the support from your electorate you must make some promises and you must also deliver the promises. And the most important promise is that you will improve your standard of living. You have to work hard, you have to go through all the reforms of which we had an opportunity to speak and the compensation for that will be the increase of your incomes, the improvement of your standard of living.

On the other side it's really true that if you want at the same time to increase GDP growth and to deliver results in meeting the Maastricht criteria, you sometimes come into difficulties. The second statement could be that meeting criteria is a very complex and complicated process and I would like to stress that in all circumstances this is a process that could be considered as a very straight process and a process which in all cases has to be sustainable.

If you look at the situation of different candidate states it is really true that there is a huge differentiation among the countries. I would like to consider only the group of Central European applicant countries: Czech Republic, Hungary, Poland, and Slovakia. The experts say that providing that nominal per capita GDP levels grow between 5 % and 6 % in euro terms in the poorest EU countries up to 2020, the applicant countries in this area should grow on an annual basis by 11.7 % in nominal terms for Slovakia, 10.1 % for Czech Republic, 11.2 % for Poland, 10.4 % for Hungary. This really requires enormous efforts to succeed in achieving such a high growth rate and at the same time you can achieve that by high price increases, high inflation. But actually this is not the case, if we really want to preserve a good investment climate and if we really want to reach another target which is the Euro zone, i. e. entering EMU. Needless to say that central bankers concentrate on price convergence and I do agree with what was said about disinflation tendencies. Although I have to say that even in pre-accession stage there are some exceptions that are just contrary to disinflation tendencies and I have to say that many of the countries had to make some corrections with administrative prices, including Slovakia. Which means that core inflation really goes down, but if you look at the headline figure it temporarily could go rapidly up and I would like to emphasize that the policy of catching up can generate high prices. Additionally, having troubles with current account deficits there is sometimes a necessity for depreciation of the currency, which again has a negative impact on inflation.

You spoke about price increases after accession and I think, indeed, that there is some evidence among the former new member states that the entry into EU did have some negative effect on price increases but anyway, in the longer-term, what we can conclude is that over time prices will converge and new member states definitely will come to the situation that prices will be much lower than is the case at present.

As a final point I just would like to draw your attention to the next convergence criteria which are extremely important and that is fiscal convergence. I would like to say that the accession, the pre-accession process is extremely costly and it really raises a lot of fiscal constraints. First, we all speak about the necessity of structural reforms. I would like to emphasize that these reforms, or most of them, are very expensive. All or most of the candidate countries have already gone through the restructuring of their banking sector and the former central bank governor of the

Czech Republic, Mr. Tošovský, just a few minutes ago just tried to draw your attention to the cost of this process. In Slovakia 11 % of GPD represents just the principal of the cost of restructuring and I have to add debt service which is quite high as well. Also, the population in the applicant countries is ageing as well and there is a necessity for pension reforms which is of course also costly in these countries and I could mention other reforms which are quite expensive.

Many applicant countries want to make the business environment more friendly. There is a real necessity for attracting FDI and the general belief in applicant countries is that the best way is to reduce taxes. But on the other side this does have negative implications on the fiscal situation – at least in the short term. There are as I said some real and significant risks to fiscal performance with the preparation for EU accession, with the adoption of the acquis communautaire, with the compliance of many EU standards, especially environmental standards, with the improvement of transport infrastructure, with building of new institutions etc. etc.

I would like to add that the list is probably not complete. And once the applicant country becomes a new member state there is another fiscal burden, an important one which is the contribution to the EU budget. That is the reason why many applicant countries would like to negotiate some, let's say, transitory conditions. I have to say that there is not a positive response from the side of the European Commission up to now although in all accessions, if you look to the 80s or 90s, all of the new member states were granted transitional arrangements. And again the problem of catching up is very often in contradiction to fiscal convergence although we do have very positive examples of euro zone countries in the mid-90s when they achieved at the same time relatively high growth and also good price development and a good fiscal performance as well.

The next point is exchange rate stability. Mr. Duisenberg spoke about the necessity of the future EU member states to be a member of the ERM for at least two years, which indicates that no new EU state will become a member of the euro zone before 2006. It's simply not possible, as we suppose that the first enlargement will be in 2004 and there is a necessity for at least two years to be a member of ERM. The problem could be – as we spoke about some temporary deterioration of inflation – that high inflation could necessitate to adjust exchange rates. I spoke also about some deterioration of the current account which could be the implication of a transitory recession but also of a synchronisation of a recession of the applicant countries with the EU countries. So currency depreciation might be required for the maintenance of the current account deficit and this could have some negative implications for meeting the criteria for an application to ERM.

We spoke about different exchange rate regimes in the different applicant countries. Most of the countries will simply have to go from the existing regime to a new one, which to some countries will be a totally new one. So if they were used to a fixed exchange rate regime they may have to change to managed floating and then probably go back again to a fixed exchange rate. I do not think that there will be any risk to keep within the fluctuation band and I think that with the exceptions which I indicated, I don't think that this will be a great problem.

I think Mr. Balcerowicz was very positive about the necessity of early accession to the EMU. Let me just enumerate some of the benefits of early accession, but on the other side I would like to mention also some negative implications of early accession, just trying to be as objective as possible. It is quite clear that especially for small economies, early entry to EMU could help to eliminate exchange rate risk which is quite huge irrespective of what are your fundamentals. Due to the fact that we succeeded in bringing down current account deficit, fiscal deficit, etc. we really from time to time can observe and are challenged with some fluctuations of the currencies. In this case there is a necessity of some improvement from the side of the central bank, for some intervention. I think that we also look forward to benefit from all the risk premiums. It is quite clear that EMU countries benefited from lower spreads that narrowed in a very speedy way from above 300 basis points to less than 30 basis points. We also expect that we will have an opportunity to benefit from a wider financial market. And I think that it is always good, even for finance ministers, if there is pressure, external pressure, on fiscal consolidation. And I think that we will not have any more problems with the proper fiscal/monetary policy mix. I know that usually central bankers blame ministers of finance that they are responsible for not making a proper combination of fiscal and monetary policy. I am not going to quarrel about that. I suppose that sometimes even central bankers are responsible for an inappropriate policy mix. But as a matter of fact, once we become a member of EMU this problem will be not a national problem, it will be just shifted to somebody else and I think national governments will benefit from that to some extent.

I think that we will benefit definitely on government debt service. There will be an easier access to a larger investor base. As I said yield curves will converge across the founding members of the EMU within a relatively short period. I suppose there could be room for closer cooperation between the government debt offices and I think that definitely this will be one of the unique opportunities. Maybe investment bankers and institutional investors will not be that happy but this is the way how to make the debt service even cheaper. There will be an opportunity for syndicated placements instead of traditional auctions etc.

Finally I just would like to say just a few words about potential disadvantages of early EMU accession. As I said the transition period will not allow to use exchange rate policy for decreasing some risks. The first one is current account deficit risks. And the applicant countries from time to time, even after the accession, will probably have to face this. Another issue is that the interest rate policy of the ECB can be, and sometimes we are a witness of that, in contrast to the policy of catching up.
I think that the debate between the finance ministers of the euro zone and the ECB is very well known and this could expand to the new member states as well. And as I said earlier, in some phases the policy of catching up could generate higher prices and probably could jeopardize price convergence targets.

And here I come to the last question which was put by the chairman of this panel: if the strictness in the handling of the criteria is not going to be relaxed to some extent. This is a question especially for the President of the ECB and I just would like to ask a very concrete question. Yesterday there was a quite interesting article in the Financial Times about the possible relaxation of budget targets, of the fiscal policy. And the question is if this could be confirmed. As this was an unofficial suggestion from those people who are connected with the ECB, could you confirm this or is it just a rumour which newspaper men like very much and they like to write quite a lot about that. Thank you for your attention.

The Euro Goes East
Key Note Address

Wolfgang Schüssel

Distinguished participants,

Allow me to use this short greeting: with so many political and financial personalities of high rank present it would be almost impossible not to upset one or the other among you. Thank you very much for inviting me to this important event and also for accommodating my – in this case very topical – scheduling needs. This morning I attended the annual Summit meeting of the Heads of Government of the Central European Initiative in Trieste. Originally founded by Austria, Italy, Hungary and Yugoslavia in 1989 the CEI today comprises 17 countries – with Austria and Italy two members of the EU, seven candidate countries, five South Eastern European states plus the Ukraine, Belarus and Moldova.

It is astonishing what has happened during the last ten years: Think of Yugoslavia, of Kosovo, of Macedonia, of Bosnia-Herzegovina. These are encouraging signals. Compared with one year ago, we are better off.

For twelve years we have been trying to build bridges over the gap created by half a century of political, economic and cultural separation. In the near future five of our Central European neighbors will join the Union. Certainly not an easy process for either side, but just as certain history in the making. And as if that were not difficult enough in itself we now have to deal with the aftermath of the terrible events of 11 September. The direct and indirect economic effects continue to impact on our respective efforts at reforms needed to make us more competitive in a globalized economy. Politically the European Union sees its already tight schedule for the completion of major projects – the Nice treaty, the EURO, enlargement, the future of Europe debate – at least partly overtaken by the need to fulfill its role as a global player right now.

But despite this huge challenge we must not lose sight of our European goals. With the start of Stage III of the Economic and Monetary Union, a zone of genuine monetary stability has been established. With EU enlargement, a huge market will be created, whose size and market potential will exceed that of the present major trading partners of the world economy.

The Stability and Growth Pact obliges all Member States to achieve budgets close to balance or budget surpluses. Not only do healthy state finances provide enough leeway for the automatic stabilizers to take full effect in economic slumps, they also contribute substantially to increasing the non-inflationary growth potential of the Euro area. Such fiscal policies reduce the debt-to-GDP ratio and consequently the interest burden for governments, increase investors' confidence in the Euro area, keep interest rates low. Actually, this is not as easy as it sounds in a written speech, but there is no alternative.

The Austrian government was just able to announce that in 2001, for the first time in more than three decades, Austria has achieved a balanced budget. The preservation of sound public finances and improvements in the structure and quality of public finances have to be the next goals.

In financial markets, the introduction of the Euro set some long-overdue structural reforms in motion, while speeding up others, as evidenced by the frequent reports in the financial media of bank, insurance and stock exchange mergers. In addition to reducing the fragmentation of 12 national financial markets in the Euro area, thereby making them more liquid and competitive, it is important that this trend produce a stable financial system. September 11 has shown how quickly financial markets can be put under severe stress and that well managed and well supervised financial markets, hand in hand with liquidity-providing central banks, can cope with even such shocking and devastating events.

The accession process has to be continued with great determination. By completing the institutional reform and adopting a road map, the Union is now – in compliance with the targets defined in Helsinki – in a position to admit new member states as from the end of 2002. In Nice, we expressed our hope, moreover, that the advanced candidate countries which are appropriately prepared would already be able to participate in the next elections to the European Parliament in 2004.

This is without doubt a very ambitious but by no means unrealistic objective. It gives the accession candidates the clear perspective they need to be able to justify the sometime very painful structural adjustments to their citizens. And it is the citizens – in both old and new Member States – who will eventually benefit most from enlargement. This reunification of Europe offers us the unique opportunity to create an area of peace, stability and prosperity in Europe.

This morning I spoke to the Bulgarian prime minister who is a decent and humble man. He deserves all support we can give him. He needs the clear assurance that they can join the train.

State of play of the enlargement process

As you know, the European Commission recently presented the “Regular Reports on progress toward accession” by each of the candidate countries. The Report points out, that all candidate countries have made substantial progress in meeting the Copenhagen criteria.

The Commission however points out that much work still remains to be done before accession.

The challenge of enlargement of the European Union

Enlargement is going to change the face of the European Union in a fundamental way. The character of the European Union has changed. For the first time since the beginning of Western European integration the vision of a United Europe becomes true. In little more than a decade the Central and Eastern European Countries have undergone enormous changes. The fall of the Berlin Wall led to a collapse of Communist governments throughout the region and to the establishment of democratic governments. Besides that the Central and Eastern European countries have started to transform their economies from planned to market systems.

Most candidate countries achieved a turnaround in their economies in 1993 or 1994 after a sharp contraction in the first years of transition. And for the first time since the start of transition in 1989, all countries recorded positive economic growth in 2000.

Growth rates in most of the candidate countries have exceeded those of the majority of the EU 15 members, but substantial convergence is still limited. Poland and Slovenia are the only two candidate countries which, in 1998, have exceed their pre-transition GDP level.

Studies estimate that with a convergence rate of 2% the ten candidate countries would then achieve per capita GDP of approximately 65% of the EU 15 average in 2037 (starting from 38% in 1997). (DIW/European Policies Research Center, 2001; The Impact of EU Enlargement on Cohesion)

Analyses of the Second Cohesion Report suggest that inequalities within the Union will increase with enlargement. Moving to an European Union of 27 members will increase the surface area of the Union by 34%, population by 28%, however, the national incomes of the candidate countries are equal to 40% of the current Union average.

The range of economic performance in income across the candidate countries is wide: some candidates (Czech Republic, Hungary, Poland, Slovakia and Slovenia) enjoyed per capita GDP´s between one-third and two-thirds of the EU average in 1999, whereas most of the candidates are below one-third of the EU average.

EUROSTAT 2001

Nominal wage levels at current exchange rates of the Central and Eastern Europe candidate countries stood at 13% of the EU average in 1999 and 14% at the end of the second quarter of 2000. However, the levels vary from 5% in Bulgaria to 40% in Slovenia. (European Integration Consortium, 2001; The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member States)

In the light of economic divergences and low wage levels special attention must be paid to Austria's neighboring countries: the proximity to several applicant countries and the income gap are main factors to let expect additional labour movement.

Austria shares 1256 km of common borders with several applicant states – almost half of its border area. Moreover, conurbations around Vienna, Graz, Linz and Klagenfurt are all situated close to the border. A similar situation prevails in Austria´s neighboring countries. Conurbations such as Ceske Budijovice, Brno, Bratislava, Györ, Sopron, Szombathely and Maribor are situated no more than 60 km from the Austrian border. Between the two capitals Vienna and Bratislava there is only a distance of 65 km. With a population of 4 to 5 million people living in the border region a certain migration as well as considerable commuter movements are to be expected.

The estimated amount of labor movement, however, is not the principal issue but rather the ability of the labor markets to absorb additional workers and to find a flexible mechanism to react to possible undesired effects in this context.

Against this background and in view of the sensitivity of this issue, Austria appreciates the transitional arrangement of a seven year´s period in the EU´s Common Position as a good basis to give all Member States of the Union, current as well new, enough time to prepare for fully liberalized labour market.

Economic integration in the pre-accession period

The last decade has been characterized by a gradual process of economic integration between the EU and the applicant countries. The most important driving force are the Europe Agreements on the step-by-step removal formal trade barriers on manufactured goods. As result, trade between the EU and the candidate countries has shown forcefully growth over the last decade. In 1998, EU exports to the candidate countries were on average 7 times higher than in 1990; the trade surplus of the EU was 25 billion €.

Geographic proximity plays a key role in trade between the EU and the applicant countries. The EU border countries Finland, Germany, Austria, Italy and Greece, in 1998, account for two-thirds of the trade with the applicants. Austria e.g. gained from rapidly expanding economic relations. Already now Austria is a huge beneficiary of the opening-up of eastern borders. Austrian export firms have extensively used the opportunity offered to them by this development. In only ten years exports to the countries of Central and Eastern Europe (CEEC) have tripled. The most significant increases were achieved in exports to Hungary, the Czech Republic, Slovakia and Poland, which more than quadrupled from 1989 to 1999.

The growth of Austrian imports from the CEEC was also above average. The CEEC´s share in Austrian imports increased from just under 7% in 1989 to 11,5% in 1999. The "cheap" Eastern imports curbed inflation in Austria and acted as a favorable cost input which enhanced the international competitiveness of the Austrian export industry.

In terms of FDI, a similar realignment towards the EU has taken place as was the case for trade flows. Foreign investment in the candidate countries has been encouraged since the start of political and economic reform process by expanding domestic markets and not least by the prospect of EU enlargement.

Again, geographic proximity plays an important role in determining bilateral FDI flows. The main investing country of the EU is Germany; it accounts for about 38% of all reported FDI stocks of the European Union (1997) in the Eastern European candidate countries. We give assistance to the south of Europe: The EBRD has given about 40 billion Euro during the last ten years.

Austria is also one of the most important investors in the CEEC, especially in the neighboring countries. Austrian companies were among the first to acquire equity shares, benefiting to a large extent from their information-based advantage. Austrian direct investments multiplied ten times from ATS 5 billion in 1990 to ATS 51.7 billion in 1997 and to nearly ATS 80 billion in 1999. The number of enterprises with Austrian participation or influence in the CEEC was 14,600 in 1998. The Austrian market share in 1999 was 4.3% in total foreign investment, and 5.1% in new investment.

Benefiting from EU enlargement

Against this background enlargement will result in particularly favorable effects for the accession countries and support their catching-up with the west. However, it will create a “win-win” type of situation, that means that the EU economy will clearly benefit from enlarging its internal market to nearly half a billion consumers, and from bringing fast-developing markets into the European economy.

Conclusion

The economic and financial integration of the candidate countries is proceeding well. For the future we have to expect three major phases in succession: First, accession countries will join the EU. This first step implies, among other things, that the economies of the candidate countries have to establish beforehand a fully functioning market economy and to attain sufficient competitiveness to participate in the single market. And I am critical on the behavior of some candidates: The most developed ask for transition periods, whereas the least developed don’t demand them. Second, the national currencies of the – then – new Member States of the EU will participate in the exchange rate mechanism (ERM II) and finally, once they fulfill the Maastricht criteria in a sustainable way, they will introduce the Euro as their own currency.

We have to think in a more creative way about countries that are not candidates, e.g. Bosnia, Macedonia etc. but want to approach the European Union. We should create a European network. We have to think about steps in between.

If we manage the enlargement process successfully, enlargement will promote stability, economic growth and employment not only in Central and Eastern, but also in Western Europe. The accession countries as well as the EU are going to benefit from such a development. Nevertheless, we have to remain realistic about the challenges which lie ahead. The accession countries have already made successful and impressive economic progress on their way, yet more remains to be done. Substantial reforms in the areas of fiscal, monetary and structural policy are of the utmost importance for the transition countries to catch up with today’s EU. The enlargement of the European Union will enhance and foster stability and prosperity in Europe even further. This is not only in the interest of Europe itself, but the world at large. Our partners will benefit from a united, open and flourishing Europe that can fully assume its role in a globalized world.

Closing Remarks

Ernst Welteke

Distinguished Guests,
Ladies and Gentlemen,

It is always a pleasure to speak at such a gathering even as the last speaker. This time, on the eve of the introduction of euro banknotes and coins, the motto of this year's Frankfurt EBC has a special significance. Something which has been vision from the very beginning of European integration is a reality: We have a single currency for a single market. And it seems to be very attractive for many non-participants as well.

At today’s conference we have tried to envisage the future development of the new currency with regard to the accession countries. We therefore had to descend from the heights of lofty ideals to the down-to-earth task of analysing the political and economic realities.

Today’s first panel discussed the political agenda of the new currency and the implications for the future. The various participants in this panel represented quite different political and economic backgrounds in terms of the prerequisites for possible accession to the euro area. Even though countries such as Sweden, Estonia or Romania seem, at a first glance, not to have so many similarities, all three are bound together by the idea of a united Europe and by shared values. The second panel concentrated on the situation of finance and banking in the accession countries. A healthy, well capitalised banking system depends on sound and robust financial markets. We have witnessed great advances in some of the accession countries. Some west Europeans are surprised by how far the transformation of certain markets has progressed.

Finally, the third panel represented the point of view of the central banks. The single currency is highly attractive for some of the prospective members-to-be. Nevertheless, one should not play down the risk of a premature “euroisation”.

The enlargement to the east is by far the most important political project that the European Union has undertaken for the coming years. We have to seize the unique opportunity to create a common future following a century of disunity and division in Europe. By overcoming the historical division of the continent, all member states will benefit. The welfare effects of the single market will more than make up for the effort expended in making the necessary structural adjustments in the accession countries.

The introduction of the euro is not only a matter of delivering banknotes and coins; it is also a question of values shared among central banks. The concept of price stability and the establishment of central banks which are independent in terms of monetary policy is now a common objective of most European countries from Portugal to Finland. It is a concept that is also reaching beyond the boundaries of the EU to the accession countries from Estonia to Cyprus.

When speaking about common values and stability in Europe as a whole, we should not forget that the euro is already the official legal tender or de facto currency in parts of eastern Europe by virtue of the role played by the D-Mark. In some of these countries, currency boards exist, which are backed – entirely or in part – by national sub-unit denominations of the euro. These countries have already opted for stability. In other countries, the D-Mark is, for the same reasons, the unofficial currency of choice. It is estimated that, in the nineties, between 30 and 40 per cent of D-Mark notes and coins were circulating outside the Federal Republic of Germany.

The widespread use of the D-Mark is a vote of confidence for the monetary policy of the Bundesbank. The efforts of the accession countries to fulfil the Maastricht criteria are an indication that a "culture of stability" is gaining ground. They also show that the European System of Central Banks and the euro already enjoy a high standing in our neighbouring countries.

At this point I would like to remind you that the monetary union not only has an eastern outlook with regard to the accession countries. It also has a northern perspective within the EU. Our friends in Denmark and Sweden, and in the United Kingdom would certainly be welcome to join. From an economic point of view, EMU membership would be beneficial. The political question of further integration still has to be resolved, however.

The European Banking Congress, which comes to a an end this afternoon, has to be seen as one link in a chain of conferences. In October, the Bundesbank hosted an international conference with leading representatives of the central banks of accession countries. Today, we have discussed the present and future role of the euro. And, in just two weeks' time, the European Central Bank and the Bundesbank will be jointly hosting a conference in Berlin on the accession process and its implications. Topics to be discussed will be the financial sector in those countries, the liberalisation of capital markets, exchange-rate regimes, and the process of convergence.

Therefore, I would like to conclude this year's European Banking Congress by reminding you: We are living in economically rough times and under great uncertainty. We do know however: The euro is already a great success and the euro goes east.