



The Euro – Towards Adopting the Common Currency in Central Europe

Horst Köhler
Managing Director of the International Monetary Fund

Prague, February 2, 2004

Governor Tuma, Ladies and Gentlemen:

1. I am very pleased to be here today and address you at the opening of this important conference. Allow me also to thank Governor Tuma and the staff of the CNB for hosting us in these beautiful facilities. Since my last visit to Prague, during our Annual Meetings in 2000, Central Europe has made decisive strides forward and, indeed, we are but months away from an historic enlargement of the European Union. And it is therefore very fitting that this conference is no longer about transition or indeed accession, but about the next step in Central Europe's integration with Europe, its adoption of the euro.

2. This conference takes place against the background of a significant strengthening of the **global economic outlook**. Led by the United States, the world economy now has the potential for a return to solid growth. The recovery is broadening and deepening, with all major regions showing improvement. And global financial markets have been supportive, with low long-term interest rates reflecting confidence in a continued low inflation environment. I expect that this will be reflected in an upward revision of the IMF's estimate for global growth in 2004.

3. **But we know that there are still risks, notably stemming from the persistent large global current account imbalances.** So far, a stronger euro and correspondingly weaker US dollar are facilitating the needed global rebalancing of current accounts. I am aware that the rapid appreciation of the euro against the US dollar, especially over the past year, has raised concerns in Europe that it could stifle the nascent recovery. I take these concerns seriously. But I also believe that we must avoid overreacting at this juncture. The euro is roughly back where it was in 1998. Its recent appreciation after a prolonged period of excessive weakness should also be viewed as a welcome sign of the increasing confidence in the common currency. Looking forward, however, I share the sentiment expressed by the euro area's Finance Ministers at their last meeting that the situation warrants close monitoring. In my opinion, what is needed now first and foremost is a credible global cooperative strategy that avoids a disproportionate burden being borne by any of the major currency areas.

4. **This strategy must be based on credible medium-term commitments by all to ensure that global growth is both robust and sustained.** This means a durable increase in national savings in the United States, with priority on establishing a framework for returning to fiscal balance over the medium term. It means an ambitious acceleration of the pace of structural reform in Europe and Japan to lift their productive potential. And in emerging Asia it means making increased use of the scope for exchange rate flexibility. Last, but by no means least, it means resisting incipient protectionist pressures in all regions and making decisive progress in trade liberalization under the Doha Round. Such commitments, made more credible by being collective, would underpin the expectation of a smooth adjustment in global imbalances.

5. **Enlargement of the European Union is an historic as well as a logical development.** After Winston Churchill said in 1946 that “an iron curtain has descended across the Continent from Stettin in the Baltic to Trieste in the Adriatic”, Europe remained artificially divided for nearly two generations. Now, the EU is retying historical economic and political bonds. Indeed, the economic reintegration of Central Europe has already been more rapid than many had expected, and the destinies of all the European economies are becoming ever more intertwined. I am confident that enlargement will bring significant benefits for old and new members alike, not least through the expansion of the internal market. But to realize these benefits requires a partnership built on mutual strength, in which both the current EU and the accession countries reinforce their foundations for long-term growth and prosperity.

6. **Europe continues to possess significant economic strengths**, including good public infrastructure, a well-educated and trained work force, and high domestic savings rates. And in numerous areas, European companies remain world leaders, competing on quality and innovation. I therefore see no need for undue pessimism. But it is clear that globalization and the accelerated integration of world markets requires always remaining in motion: i.e. the economic and political ability to adapt to constant change. New growth hubs are emerging in Asia, where growth has outpaced Europe by 5 percentage points per year over the past decade – and according to the IMF’s *World Economic Outlook* will continue to do so in the coming years. Therefore, in my view a larger Europe must also become a stronger Europe, based on fundamental inner strength and self-confidence, which is outward-looking and capable of competing successfully in the global economy.

7. **Realizing Europe’s potential requires both change and perseverance.** The EU needs to accelerate the implementation of structural reforms, especially in labor and product markets, to ensure that it can take full advantage of its large internal market and compete in the global economy. We must all welcome the Irish Presidency’s initiative to place the implementation of the Lisbon Strategy at the top of Europe’s agenda. Moreover, the implementation of the EU’s Financial Services Action Plan, based on the recommendations of the Lamfalussy Committee, is a valuable opportunity to improve the depth and efficiency of Europe’s capital markets. Together, these efforts provide the right basis for durably strengthening innovation and growth in Europe. I also hope that work can be completed

expeditiously on a Constitution for Europe that provides a strong foundation for the political union and ensures that it can work effectively.

8. **I agree with Jean-Claude Trichet when he said recently that the euro has become a strong symbol of Europe.** Since its inception, the euro has unquestionably been a major success. It has contributed to a significant strengthening of the international financial system by eliminating disruptive currency crises among major trading nations in Europe. Most importantly, the euro has helped to achieve a low-inflation environment in Europe. The European Central Bank has established itself as a strong and independent institution, and has lived up fully to its mandate to maintain price stability. I would like to pay tribute to Wim Duisenberg, Tommaso Pado-Schioppa, and the other members of the Governing Council of the ECB for successfully guiding the euro through the choppy waters of its first five years.

9. **The Central European countries poised for EU accession can rightfully look back to significant economic achievements over the past decade.** Macroeconomic stabilization has been followed by comprehensive economic restructuring, which is creating increasingly competitive economies, not least thanks to continued high inflows of foreign direct investment. Eventually joining the common currency area will provide a further significant boost to economic development through increased trade and financial flows by lowering transaction costs and eliminating market risks. But this is not the time to relax. The gains from adopting the euro will not accrue automatically. Western Europe's own experience of the 1990s showed that while in some countries the euro adoption process served as an incentive for economic reform and adjustment, in others – especially the larger countries – it did less so. Indeed, it showed that there is a risk that the absence of exchange rate constraints can lead to a relaxing of the policy guard, at a cost to long-term growth and prosperity.

10. **Economic policies in Central Europe therefore need to be strong and forward-looking.** The Maastricht criteria remain the measure for euro adoption. Their spirit has always been clear, namely to ensure solid economic fundamentals and durable convergence, which is also the best safeguard against the risk of destabilizing capital flows in the run-up to adopting the euro. And this would be helped, in particular, by early and ambitious fiscal adjustment, which in some cases could well go beyond the requirements of the Maastricht criteria for public debt and deficits. Moreover, financial market supervision needs to be acutely aware of the risks to domestic financial stability stemming from the rapid credit growth that can accompany euro adoption. The loss of the monetary policy instrument after euro adoption will shift the burden of adjustment to shocks to other channels, notably to fiscal policy and wage and price flexibility. Policy makers need to be aware of these fundamental changes to economic policy instruments – and must begin to prepare for them now.

11. **Adopting the euro offers significant economic benefits for both current and future members of the euro area.** Economic analysis suggests that, over the long term, euro adoption could raise GDP by an additional 20-25 percent in most Central European

countries.¹ And for the existing members of the euro area, traditional trade creation benefits will be complemented by long-term gains in political and economic stability that accompany successful currency unions. Realizing these gains will require strong and credible policies both within the current euro area and in the acceding countries. It also requires clarity and transparency in mapping out the path toward the euro for the new members and avoiding any ambiguity regarding the application of the criteria so as to minimize market uncertainty and volatility. This conference, and the in-depth analysis prepared by IMF staff, should be regarded as a basis for discussion, not its conclusion. I see it as an integral part of the IMF's surveillance mandate and our contribution, through dialogue, to promoting a smooth adoption of the euro in Central Europe. The path and pace will differ according to individual country circumstances, but there should be no doubt about the final destination.

Ladies and Gentlemen:

12. Ditie, the protagonist of Bohumil Hrabal's most famous novel set in the Hotel Pariz less than 200 meters from here, ended his narrative by saying that his is a "story of the unbelievable come true". Some, looking back at a continent ridden by conflict during most of the 20th century, may be tempted to say the same about European unification. But in my view, Europe today is rather the story of the believable being realized, through hard work, dedication, and determination. This conference today will surely also bring out disagreements and points of difference. But we must not lose sight of the historical achievements realized across the continent. I am confident that, with continued determination, Europe and the euro have a bright future.

Thank you.

¹ *Adopting the Euro in Central Europe – Challenges of the Next Step in European Integration*, International Monetary Fund 2004 (forthcoming).