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REPORT

on the draft recommendation of the Council concerning the appointment of Mr José Manuel González-Páramo as a member of the Executive Board of the European Central Bank

(6315/2004 - C5-0176/2004 - 2004/0808(CNS))

Committee on Economic and Monetary Affairs

Rapporteur: Christa Randzio-Plath

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PROCEDURAL PAGE

By letter of 30 March 2004 the President of the Council consulted Parliament pursuant to Article 112(2)b of the EC Treaty on the Council's recommendation concerning the appointment of a member of the Executive Board of the European Central Bank (6315/2004 - 2004/0808(CNS)).

At the sitting of 19 April 2004 the President of Parliament will announce that he had referred the recommendation to the Committee on Economic and Monetary Affairs as the committee responsible (C5-0176/2004).

The committee decided to draw up a report and appointed Christa Randzio-Plath rapporteur at its meeting of 6 April 2004.

It considered the draft report at its meeting of 6 April 2004.

At the latter meeting it adopted the proposal for a decision by 11 votes to 2, with 2 abstentions.

The following were present for the vote: Christa Randzio-Plath, chairwoman and rapporteur; Philippe A.R. Herzog, and John Purvis, vice-chairmen; Renato Brunetta, Salvador Garriga Polledo (for Generoso Andria pursuant to Rule 153(2)), Robert Goebbels, María Esther Herranz García (for Ioannis Marinos pursuant to Rule 153(2)), Othmar Karas, Alain Lipietz, Astrid Lulling, Hans-Peter Mayer, Juan Andrés Naranjo Escobar (for Brice Hortefeux pursuant to Rule 153(2)), Marcelino Oreja Arburúa (for José Manuel García-Margallo y Marfil pursuant to Rule 153(2)), Olle Schmidt and Alexander Radwan.

The report was tabled on 13 April 2004.

PROPOSAL FOR A EUROPEAN PARLIAMENT DECISION

on the draft recommendation of the Council concerning the appointment of Mr José Manuel González-Páramo as a member of the Executive Board of the European Central Bank

(6315/2004 – C5-0176/2004 – 2004/0808(CNS))

The European Parliament,

- having regard to the Council's recommendation of 30 March 2004 (6315/2004),
 - having regard to Article 112(2) (b) of the EC Treaty pursuant to which the Council consulted Parliament (C5–0176/2004),
 - having regard to Rule 36 of its Rules of Procedure,
 - having regard to the report of the Committee on Economic and Monetary Affairs (A5-0273/2004),
1. Delivers a favourable opinion on the appointment of Mr José Manuel González-Páramo as a member of the Executive Board of the European Central Bank;
 2. Instructs its President to forward this decision to the President of the Council, for forwarding to the governments of the Member States.

EXPLANATORY STATEMENT

Introduction

1. By letter of 30 March 2004, the Council consulted the European Parliament on the nomination of Mr José Manuel González-Páramo as a member of the Executive Board of the European Central Bank for a term of office of eight years. Parliament's responsible Committee on Economic and Monetary Affairs then proceeded to evaluate the credentials of the nominee, in particular in view of the requirements laid down in Article 112 of the Treaty and in the light of the need for full independence of the ECB pursuant to Article 110. In carrying out this evaluation, the Committee received a CV from the candidate (see Annex 1) as well as his replies to the written questionnaire that was sent out to him (see Annex 2). The committee subsequently held an hour-and-a-half hearing with the nominee on 6 April 2004, at which he made an opening statement (see Annex 3) and then responded to questions from members of the committee. (The full transcript of the hearing is available both in paper form and on the committee's Internet site.)

Evaluation

2. The rapporteur considers that the nominee's record demonstrates that Mr José Manuel González-Páramo is an excellent candidate in terms of the main requirements laid down in the Treaty, namely personal integrity and recognised standing and professional experience in monetary and banking matters. All this was amply confirmed by the nominee's replies at the committee hearing on 6 April 2004.
3. Nevertheless, during the debate, Committee Members expressed the view that the ECB should be invited to organise a conference on the future of central banking in view of examining the evolving role of central banking in the EU, together with the European Parliament and representatives of the social partners.

CURRICULUM VITAE

José Manuel González Páramo

(Madrid, August 1958)

1. Academic Titles

- Ph.D. Economics (Columbia University, New York, 1986)
- Doctor en Ciencias Económicas (Universidad Complutense, Madrid, 1985).
- Other: M. Phil. Economics (Columbia U, 1984), MA. Economics (Colombia U., 1983) and Licenciado en Ciencias Económicas (Universidad Complutense, 1980)

2. Academic Positions

- Full Professor (Catedrático) of Public Finance (Universidad Complutense) since May 1988
- Head of the Public Finance Department (Universidad Complutense; 1986-1998).
- Director, Master on Public Finance and Economic Analysis (Graduate Studies, Instituto de Estudios Fiscales; 2002-).
- Professor of Public Economics (Centro de Estudios Monetarios y Financieros, CEMPI, Grad. Studies, 1989-)
- Professor of Taxation (Instituto de Estudios Fiscales-Master on Public, Finance and Ec. Analysis; 1989-1996)
- Professor of Fiscal Policy (Fundación Ortega y Gasset-Doctoral Degree on European Economy; 1995-)
- Professor of Public Management and Economic Analysis of Public Organisations (Fundación de Estudios Iberoamericanos; 1998-2003).

3. Professional Activity

- Member of the Governing Board, Bank of Spain (1994-1998, 1998-2001 and 2001-).
- Member of the Executive Board, Bank of Spain (1998-2001, 2001-).

- Project Manager (European Academy of Arts and Sciences; 2000-)
- Senior Research Associate (Research Department, Bank of Spain; 1989-1994)
- Director, Centro de Estudios de Economía Pública (Fundación Banco Bilbao Vizcaya; 1991-1994).
- Research Associate (Fundación Fondo para la Investigación Económica y Social.. Confederación Española de Cajas de Ahorros, Madrid, 1987-1989)
- Research Associate (Secretaría de Estado de Hacienda, Ministerio de Economía y Hacienda, Madrid, 1995-1987)
- Research Fellow (Instituto de Estudios Fiscales, permanent since 1980)
- Consultant (The World Bank Washington DC, 1984, 1989, 2000-2001)
- Consultant (Centre for Economic Policy Research, 1988)
- Consultant (International Development Bank - Argentina~ 1998)
- Consultant (EEC Commission, 1989-1993)
- Consultant (Several government agencies; Spain; since 1985)

4. Published Articles, Books and Monographs

The candidate has published about 190 theoretical and applied articles in professional journals (in Spanish and English). Two-thirds of these papers have gone through peer-review processes. Works also published in 20 books, 45 chapters of books *and* 75 researches monographic. (See *selected publications (in English)*).

5. Positions in Editorial Boards

- Editor-In-Chief, *Hacienda Pública Española/Revista de Economía Pública* (2001-)
- Associate Editor, *Spanish Economic Review*, Springer-Verlag (1997-2000), and *Estudios sobre Economía Española* (electronic publication; www.fedea.es; 1999-)
- Member of the editorial board of the following academic journals: *Papeles de Economía Española* (1987-1994); *Suplementos Financieros/Papeles de Economía Española* (1987-1994); *Actualidad Financiera* (1987-1988); *Revista de Economía* (1989-1992); *Hacienda Pública Española* (1990-2001); *Presupuesto y Gasto Público* (1997-); *Investigaciones Económicas* (1990-1994); *Economistas* (1996-); *Revista de Economía Aplicada* (1996-2002); *Análisis Local* (2000-); *Análisis Financiero Internacional* (2000-).

6. Scholarships and Academic Honours

Award to the Distinguished Economist 2001, Awards for the Promotion of the Economic and Financial Culture, sponsored by the journal *Inversión* (former award-winners: J.A. Sánchez Asaín, L.A. Rojo, J. Alcaide, E. Fuentes Quintana, E. Domingo Solans and J. Velarde).

VIII Premio del Círculo de Empresarios (2002).

Member, European Academy of Arts and Sciences (2000-),

Member of the Official Commissions on the Reform of Regional Finances (Ministry of Economics and Finance, June, 1996-Sept., 1996 and Sept., 2000-March, 2001)

Member of the Executive Board of Fundación CEMFI (*Centro de Estudios Monetarios y Financieros*; 1996-),

Vice-president and founding member of the Asociación Española de Economía Pública, May, 1994.

Member, International Institute of Public Finance (1986-); Member, European Economic Association (1987-); Founding Member, Spanish Section of the Public Choice Society (November, 1980).

Scholarships and honours: *Fulbright Scholar* (Department of Economics, Columbia University, **New York, 1982-1985** * Graduate School of Arts and Sciences (OSAS), Columbia University, Honorary Fellow, Sept., 1982-May, 1984; OSAS, Columbia University, *President's Fellow*, Sept., 1984-May, 1985-, Banco de España, *Beca para la Realización de Tesis Doctorales*, May, 1984-May, 1985, Universidad Complutense, *Premio* Extraordinario de Licenciatura* in Economics, 1981; Universidad Complutense, *Premio Extraordinario, de Doctorado* in Economics, 1986).

Selected publications (in English)

1. "Public ownership and business performance, Empirical evidence with panel data from the Spanish manufacturing sector (with Hernandez de Cos and I. Argimón), *Public Finance Review* vol. 32, No. 2. pp. 148-182. (2004).
2. "Fiscal Consolidation in Spain; Dynamic Interdependence of Public Spending and Revenues" (with P. De Castro and P. Hemández de Cos), *Investigaciones -Económicas*, XXVIII (1), pp. 293-307 (2004).
3. "Public investment and consequences of the Spanish regions" (with D. Martinez López), *The Review of Regional Studies*, 33 (2), 2003.
4. "The role of the State and economic consequences of alternative forms of public expenditures financing" (with Blanca Moreno-Dodson, WBI Working Papers, World Bank Institute, The World Bank (2003).

5. "Taxations of Savings Products" (with N. N. Badenes and Yannick L'Horty), Observatories de l'Espagne Europeenne, París, June (2001),
6. "Social Security in Europe: The case of Spain", in E. Baldacci and F. Peracchi (eds); *Reforming the Social Security System.- An International Perspective* (others authors; A. Böesch-Supan, P. Pestica, M. Persson y R. Disney), ISTAT (National Institute of Statistics -Italy), Rome, pp.159-176 (2000).
7. "A cost-benefit analysis of going from low inflation to price stability In Spain` (with J.J. Dolado and J. Viñals), in M. Feldstein (ed.); *The costs and benefits of price stability*, National Bureau of Economic Research-University of Chicago Press, Chicago, Illinois, 95-132 (1999).
8. "Evidence of public spending crowding-out from a panel of OECD countries", *Applied Economics*, 29, pp. 1001-1010 (1997)
9. "Fiscal policy in Spain, 1980-1992: Main developments and current issues» (with A. Utrilla and A. Valiño), *European Economy (Reports and Studies)*, Nº 3. 1994, pp. 13-184 (1994).
10. "Tax and spend or spend and tax"? Causality between revenues and expenditure and the size of the public budget in Spain, 1955-1991", *European Economy (Reports and studios)*, nº 3, 1994, pp. 166-170 (1994),
11. "Infrastructures, productivity, and crowding-out: The case of Spain" *European Economy (Reports and Studies)*, No 3, 1994, pp. 171-173 (1994).
12. "Tax shifting through mobility in the theory of tax incidence", *Public Finance/finances Publiques*, vol. 48(3), pp. 111- 113 (1993).
13. "Productivity and Infrastructure in the Spanish Economy" (with L. Argimón. M.J. Martín and J. Mª Roldán) Banco de España, Servicio de Estudios, Documento de n. 9313 (1993).
14. "Tax Shifting through Mobility», *Investigaciones Económicas*, vol. XVII (I), pp., 195-203 (1993).
15. "Effective Taxation of Savings Income in Spain, Banco de España, *Economic Bulletin*, January, pp. 137-146 (1992).
16. Issues on fiscal policy in Spain, in Various Authors, Current Issues in Fiscal Policy and their implications for the Conduct of Monetary Policy, Bank of International Settlements Basel, pp.189-220 (1992),
17. "Spain and the EEC cum 1992, shock" (J. Viñals et al.), in C. Bliss and J. Braga de Macedo (eds.): *Unity with Diversity in the European Econom. The Community's*

Southern Frontier, Cambridge University Press-CEPR, Cambridge, pp. 145-214 (1990),

18. Argentina; *Tax Policy for Stabilization and Economic Recovery*, with L. Barbone y R. Bird (dirs), Banco Mundial (BIRD Washington DC, 145 pp. April (1990).
19. "Optimal Intervention in the Presence of Categorical Equity Objectives" (with De-Piao Tang), *Public Finance/Finances Publiques*, 43, n° 1, pp. 79-95 (1988).
20. "Optimal Allocation of Categorical Equity" (with De-Piao Tang), *Academia Economic Papers*, Taiwan, 15, pp. 101 – 118 (1987).

Answers to the questionnaire by
Mr José Manuel González-Páramo,
Candidate to be a member of the Executive Board of the
European Central Bank

A. Personal and professional background

1. Please highlight the main aspects of your professional experience in monetary, financial and business matters.

After obtaining an Economics degree from the Complutense University of Madrid (UCM), I completed postgraduate studies in public finance, monetary economics and international economics at the UCM and Columbia University (New York). I hold a doctorate degree in Economics from UCM (1985) and a Ph.D. in Economics from Columbia University (1986).

My professional experience can be summarised as a combination of academic activity, advisory tasks and the decision-making process in central banking.

In 1988 I became a full professor of Economics at UCM, where I have taught courses on public finance (macro and micro), European economics and public management. Apart from that, I have taught advanced courses in economic analysis at the Madrid Centro de Estudios Monetarios y Financieros (CEMFI), among other research centres. My publications and research have focused mainly on fiscal policy, the economic effects of public spending and taxation, and the costs and benefits of disinflation.

From 1985 to 1994 I held positions as an economic adviser to various public and private institutions: the Spanish Ministry of Economics and Finance (1985-1987), Fundación Fondo para la Investigación Económica y Social (1987-1989), and the Bank of Spain (1989-1994), among others.

Since July 1994 I have been a member of the Governing Council of the Bank of Spain, and a member of its Executive Board since July 1998. In my capacity as a member of these two decision-making bodies I have been responsible for setting the policy line at one of the Eurosystem's central banks, the Bank of Spain, on major issues encompassing monetary policy, preparations for Monetary Union and financial supervision.

2. Please highlight the main aspects of your European and international experience.

The main aspects of my European and international experience stem from my role as a member of the decision-making bodies of the Bank of Spain, as well as from my professional activity as an economic adviser and as a member of the academic community.

First, as a member of the Governing Council and of the Executive Board of the Bank of Spain, I have been involved in the preparation of the Third Stage of Economic and Monetary Union. Further, as a member of the Executive Board I am jointly responsible for setting guidelines for the contribution of the Bank of Spain to the discussions and decision-making on key issues in the Eurosystem. In this respect, I had the opportunity to follow the activity of the main working groups and to become involved in the preparation of the positions of the Bank of Spain as regards its participation in the Governing Council of the European Central Bank.

Secondly, I should refer to my participation in working groups on economic and financial matters at the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development (OECD). I took part in these fora in my capacity as an economic adviser to the Bank of Spain. Moreover, I have undertaken independent advisory and consultancy work in monetary, budget and fiscal matters for the European Commission (D-G for Economic and Financial Affairs) and the World Bank (Argentina, Colombia and the World Bank Institute), among other international institutions.

Lastly, I have published my research on fiscal and economic issues in international journals and books edited by prestigious publishing companies. Furthermore, I am a member of the European Academy of Arts and Sciences and of the International Institute of Public Finance.

3. What are the most important decisions to which you have been party in your professional life?

I have indirectly referred to some of the most important decisions in which I have taken part in my response to the two preceding questions. Nevertheless, I would highlight the following:

First, my involvement in the design and implementation of a new monetary policy strategy at the Bank of Spain. In 1995, against the background of the peseta's membership of the Exchange Rate Mechanism (ERM) and after the Bank of Spain was endowed with full independence, a monetary targeting-type strategy, the so-called "two-stage scheme" was discontinued and replaced by an inflation targeting-type strategy, namely "direct inflation monitoring". This new framework proved successful in bringing inflation below 2% in 1998, just before the inception of the euro, while being compatible with the restrictions set by the ERM to a fully autonomous monetary policy.

As a member of the decision-making bodies of the Bank of Spain, I have been involved in the design of Stage Three of EMU and its implementation in Spain. A particularly important milestone in this respect was the euro cash changeover.

Thirdly, I have been actively involved in all the decisions concerning banking supervision and regulation in Spain over the last ten years. Among the latter, I may cite the creation of a new statistical (dynamic) provision aimed at reinforcing medium-term solvency through a proper recognition of ex ante credit risk. Besides this, I have also participated

in the design of a framework for the evaluation and monitoring of financial stability in the banking sector.

Finally, I should mention my role in the reform of the rules and procedures geared to deficit restraint and budget stability. I participated in these decisions as an adviser, as a member of working groups, and as an author of academic and professional publications.

- 4. Do you have any business or financial holdings or any other commitments which might conflict with your prospective duties, and are there any other relevant personal or other factors that need to be taken account of by the Parliament when considering your nomination?**

I have neither any business or financial holdings nor any other commitments which might conflict with the duties of an ECB board member. Apart from that, I am not aware of any personal or other factors that might need to be taken into account by the European Parliament with respect to my nomination.

B. Monetary and economic policy

- 5. What would be the guiding objectives you will pursue during your eight-year mandate as a Member of the Executive Board of the European Central Bank?**

First, while adhering to the highest possible degree of professionalism and integrity, I would be committed to the achievement of the ECB's primary objective as laid down in the Treaty, namely the maintenance of price stability.

Second, I would act in the general interest of the euro area as a whole.

Third, I would fulfil my functions and roles with independence, while maintaining a high level of transparency and accountability.

And fourth, I would strive to perform my duties in accordance with the principle of collegiality in the functioning of the decision-making bodies of the ECB.

- 6. Given the fact that the recently clarified ECB's definition of price stability is inflation rates for the Euro area "below, but close to, 2% over the medium term", how do you contest the view that explicit inflation forecasts over this medium term would improve the ECB's communication policy?**

My own recollection is that in 1998 the Governing Council announced that its monetary policy strategy was going to be based on a quantitative definition of price stability, defined as a year-on-year increase in the HICP of below 2%. In May 2003 the Governing Council confirmed its definition of price stability and clarified that, in the pursuance of price stability, its aim was for inflation rates in the euro area below but close to 2%.

That said, I believe inflation forecasts are a useful tool for organising a large body of economic data. In this respect, they are an important piece of information for the policymaker. This assessment lies behind the Governing Council's decision to publish the Eurosystem staff's macroeconomic projections on a bi-annual basis, a process which fully harnesses the technical expertise existing both at the local NCB level and at the ECB.

However, in my view inflation projections cannot be an all-encompassing tool for the policy-decision process or for the external communication of policy decisions, as they may have a number of drawbacks. For example, one should never forget that inflation forecasts are model-specific and cannot take into consideration in a timely manner all available data and analyses. This is particularly true for the euro area, as many statistics become available with various time lags. In addition, developments in financial and monetary conditions, which are of great importance for the determination of price dynamics, are generally not included in the standard macroeconomic models employed to construct macroeconomic forecasts. Policy decisions need instead to be taken on the basis of the largest possible set of information, thus broadening rather than restricting the scope of analysis of the decision-making body. Furthermore, in order to take monetary policy decisions one also needs to apply judgement, which often goes beyond mechanistic forecasts.

There are also some problems related to publishing forecasts at a pre-specified medium-term horizon. One problem is that all sources of uncertainty are, of course, exacerbated as the horizon lengthens. Another problem concerns the very notion of the medium term in relation to forecasts. The reality is that the lags of monetary policy transmission are uncertain and variable, depending on the nature and strength of the shocks impacting the economy. As a consequence, the degree of relevance and appropriateness of constructing an inflation forecast over a specific horizon varies with the origin, nature and magnitude of the shocks besetting the economy at a particular time. For example, the appropriate time frames for analysing the inflation effects of a demand and a supply shock are quite different.

In my view, these are sufficient reasons to believe that the adoption of inflation forecasts as the main communication tool of the central bank with the public involves quite a few problems.

7. Without prejudice to the objective of price stability (which seems at present to be under control), how in your view should the ECB fulfil its secondary obligations under the Treaty (to contribute to economic growth and full employment) and what instruments could the ECB use to do so?

It is not only my belief, but also the almost unanimous conclusion of the academic community, that the ECB, through its commitment to maintaining price stability over the medium term, provides its best contribution to sustainable economic growth and higher welfare in society.

This can occur through several channels. Inter alia, price stability improves the transparency of the relative price mechanism, which is the basis of a soundly functioning market system. Price stability minimises inflation risk premia in interest rates, thus lowering financing costs and stimulating investment. Furthermore, a medium-term orientation in the maintenance of price stability can avoid introducing unnecessary volatility into the economy and embodies a concern for and a contribution to the stabilisation of output and employment. This is particularly important when the economy is hit by supply shocks. In other instances, namely in the face of demand shocks

impacting the economy, a monetary policy based on price stability does not normally entail a trade-off with stabilising output and employment.

Price stability contributes to achieving high levels of economic growth and employment in other ways. Thus, price stability minimises the real costs entailed when inflation exacerbates the distortions created by tax and social security systems. At the same time, price stability reduces transactions costs in cash operations. Furthermore, price stability prevents the arbitrary redistribution of income and wealth.

It is however important to recognise that monetary policy has limitations and, beyond its contribution to economic growth via the maintenance of price stability in the medium term, it cannot increase the growth potential of the economy or reduce the high level of unemployment which unfortunately plagues the euro area. Improving growth and employment prospects must rely on structural reforms.

In my view, the unprecedented low levels of interest rates currently prevailing in the euro area offer evidence that the medium-term orientation of the monetary policy of the ECB is able to provide full support to output and employment considerations.

- 8. In the context of the debate on the Stability and Growth Pact (SGP), what is your opinion on how the Pact should evolve in the near-term future? Do you consider the SGP as either a rules-based system or a policy-based one? What can be done to redefine the medium-term budgetary targets, and correct the pro-cyclical fiscal bias of the SGP in good times? How would you solve the lack of proper enforcement of the Pact, and what is the way to move towards non-partisan application of the rules?**

The main objective of the Stability and Growth Pact is to preserve the sustainability of public finances while ensuring adequate flexibility to smooth economic fluctuations. The fiscal rules set in the Stability and Growth Pact provide an appropriate framework to achieve these objectives. Fiscal sustainability is guaranteed if Member States comply with the reference values in the Treaty and the close-to-balance-or-in-surplus position. At the same time, maintaining a budgetary position close to balance or in surplus allows automatic stabilisers to operate fully over the cycle, and to smooth economic fluctuations. Compliance with the Pact therefore ensures that fiscal policy works symmetrically over the cycle and that there is no pro-cyclical bias.

From a procedural perspective, the Stability and Growth Pact is not a blind and rigid scheme to constrain fiscal policies either. The Stability and Growth Pact sets up a sequence of incentives for countries to prevent and correct severe budgetary imbalances. At each instance of this sequence, a country's fiscal efforts and changes in the economic environment are assessed and taken into account for the design of further steps.

The fiscal restraint imposed by the Stability and Growth Pact anchors economic agents' confidence in the soundness of public finances which, in turn, is a pre-condition for the proper operation of the monetary union. It contributes to confidence, provides favourable conditions for investment, and is therefore an important ingredient as regards long-term growth.

The contribution to long-term growth is enhanced if governments correct fiscal imbalances as part of a comprehensive structural reform agenda that also improves the “quality of public finances”. In this regard public expenditure restraint is pivotal. Only expenditure restraint can help finance the elimination of imbalances, the further reduction of taxes and the shifting of spending to productive areas. Fiscal structural reform in conjunction with deficit and debt reduction will also help prepare for the costs of population ageing. These medium-term benefits are important and have not always received sufficient attention in the debate on the Pact.

The Stability and Growth Pact is a rules-based system that further specifies the legal provisions of the Maastricht Treaty. With regard to any policy proposals to change the rules of the current framework, it is my view that there is no need for changes in the current form of the Maastricht Treaty or the Stability and Growth Pact. However, the implementation of the Pact could be further improved, in particular as regards the analysis of structural balances and the strengthening of the incentives for sound fiscal policies in good times. Clarity and enforceability of the fiscal framework should also be enhanced.

In my personal opinion, current problems are not the result of undue rigidities of the framework. Rather, they reflect the political unwillingness of some countries to comply with the commonly agreed rules. What is needed now, and what will remain essential in the future, is therefore a clear commit by all parties involved to maintain an effective framework for policy co-ordination and to improve the implementation of the existing rules.

9. What are in your view the main causes of the volatility of the exchange rate of the Euro, and its consequences in political, economic and financial terms? Do you consider this excessive volatility as a danger for monetary policy, and if so, what can be done to reduce it? What importance do you give in this context to the dangers posed by the twin US deficits?

Starting with a factual observation, it seems that while the appreciation of the euro exchange rate seemed to have come to a halt during the opening months of 2004, volatility in the foreign exchange markets has recently increased. That said, it is immediately necessary to add that it is always difficult to explain developments in foreign exchange markets. For example, foreign exchange markets may have been affected by the fact that, despite the improving outlook for global demand conditions, some uncertainty remained about the short-term economic outlook in some of the main economic areas.

Heightened volatility, which is commonly associated with increased uncertainty regarding the appropriate course of exchange rates, could have an adverse effect on the economy. From the real economy perspective, exchange rate fluctuations complicate the prediction of future revenue growth for companies involved in foreign trade and could work as an impediment to investment. For financial markets, sharp movements in exchange rates can cause losses to leveraged positions that might easily spread to other asset classes. Finally, for central banks, exchange rate volatility complicates the assessment of medium-term inflationary perspectives.

It is my belief that the ECB contributes most effectively to limiting volatility in foreign exchange markets by pursuing its stability-oriented monetary policy framework as outlined in its monetary policy strategy. Moreover, there is a broad consensus among central banks that exchange rates need particularly close monitoring in periods of heightened volatility. In such episodes, clear and appropriate communication to the public is a potent tool for smoothing market conditions.

It is a widely held belief that the monetary policy strategy of a large and relatively closed economic area such as the euro area cannot embody an implicit or explicit target for the exchange rate, since this would clash with the maintenance of domestic price stability. This does not mean that the euro exchange rate should not play any role in the ECB's strategy. On the contrary, with a view to the potential impact of exchange rate developments on future price developments, exchange-rate dynamics must be closely monitored. However, I fully share the view that monetary policy should not react to a single privileged indicator or a few selected indicators in a mechanistic manner. Any monetary policy decision depends on the overall economic situation and needs to be based on a comprehensive analysis by the Governing Council of all relevant indicators, factors and risks to price stability. I therefore believe that excess volatility in the exchange rate should be contained by addressing its underlying causes and the structural shocks that may have caused it.

Overall, I believe that a monetary policy that avoids erratic reactions and conveys a steady sense of direction to the markets is the best antidote to the development of excessive volatility in all financial markets, including the exchange rate market. Regarding the issue of the US twin deficits, my personal view is the following. Generally speaking, any economy with insufficient domestic saving, either public or private, has to resort to international capital to finance the gap. Moreover an excess of the overall domestic demand on output is reflected in a current account deficit. In this context the size of the economy matters. For small sized economies the share of world savings received will tend to be small. However, for a large economy like the US the international capital inflows represent a high proportion of the world savings and therefore the impact of the external deficit on the international capital market is substantial.

In recent years, the US budget deficit has been increasing and this has been associated with a higher US external deficit since private net saving has been insufficient to counter this move. The main danger with the so-called US twin deficits and, in particular, the US external deficit is that -if left uncorrected- the latter, in combination with a potential uncertain outlook for the US economy, could restrain international capital flows to the USA and therefore precipitate a disorderly fall in the dollar. Moreover, as Asian countries peg their currencies to the dollar, the dollar depreciation could affect disproportionately the euro-dollar exchange rate, thus adversely affecting the nascent European economic recovery.

For these reasons, it is of the utmost importance that policy action be taken to address the US external deficit problem. In this regard, the reduction of the US fiscal deficit is necessary while enhancing potential growth in Europe would also be of great value.

10. How can the representation of the Euro area and its currency be further enhanced, in particular in international financial institutions? What do you think about the respective roles of the ECB, the Commission and the Member States in the external representation of the Euro?

How do you consider the idea of designating a "Mr/Mrs Euro" for this external representation?

At present, the division of labour for external representation between the different institutions differs for monetary, exchange rate and economic policy issues.

On monetary policy issues, it is solely for the ECB, and most visibly its President, to represent the euro area externally. Exchange rate policy is a shared responsibility between the ECB and the Council. This concerns consultation with our partners. For instance, in G7 meetings both the ECB President and the Eurogroup President participate when matters related to the exchange rate of the euro are discussed. By contrast, the ECB is solely responsible for deciding and conducting interventions. This also implies that the ECB President is the only counterpart of the other G7 monetary authorities for deciding on interventions.

On economic policy issues, which lay mainly in the domain of Member States, national governments have over recent years stepped up efforts to co-ordinate their stance in international financial institutions. The ECB also plays a role here. For example, Member States co-ordinate under the chairmanship of the EU Presidency before the IMF Board meetings in the so-called Euro-IMF meetings, in which the ECB participates.

To my mind, this division of labour is fully in line with the allocation of responsibilities set out in the Treaty. External representation is however a gradual and dynamic process. It seems to me that there is scope for further improvement. In particular, co-ordination among Member States could be further intensified. However, overall the current system functions rather well.

11. Which responsibility and role should the ECB have concerning financial stability? Would you be in favour of the publication by the ECB of financial stability reports? What should the ECB's responsibilities be regarding financial and banking supervision?

The Treaty already assigns specific statutory responsibilities to the ECB and the Eurosystem in the field of financial stability. First, the Eurosystem is responsible for promoting the smooth operation of payment systems in the euro area. This is a clear competence in the field of financial stability, given the relevance of market infrastructures as a major component of the financial system and, accordingly, as a possible channel for contagion in stress situations.

Second, the Eurosystem has the task of contributing to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. This provision appears to acknowledge that the central banking tasks exercised at the Community level may contribute to enhancing the pursuance of financial stability and supervisory policies at the national level. In practice, the contribution of the Eurosystem has mainly taken the form

of promoting co-operation among banking supervisory authorities, and between these and the national central banks and the ECB. In this context, the role of the ESCB's Banking Supervision Committee plays an important role.

And third, the Treaty and the ESCB Statute recognise the contribution, also from a financial stability perspective, that the Eurosystem can make to shaping effective financial regulations and enhancing supervisory practices. The ECB must be consulted on any draft Community and national legislation in the fields of banking supervision and financial stability, and it can propose, on its own initiative, advice on the scope and implementation of European legislation in these areas.

In more concrete terms, the Eurosystem, as the central bank of the euro area, should have a strong interest in the pursuit of financial stability within the area for the same reasons that underlie the interest of central banks at the national level. In general, given the transmission mechanisms for monetary policy, central banks are concerned with the ability of the financial system to withstand adverse shocks and thus focus their financial stability activities on monitoring possible channels for contagion and the overall exposure to systemic risk.

The potential role of the Eurosystem in financial stability should be seen against the background of the ongoing integration of European financial markets, which in some instances has been accelerated by the introduction of the euro and the single monetary policy. Further integration has meant closer linkages among financial institutions, markets and market infrastructures. In a situation of stress, it is increasingly likely that contagion will spread across national borders, which also means that systemic risk may assume a euro area dimension. The EU and the euro area should therefore have appropriate arrangements in place for monitoring and containing possible threats to financial stability, where the contribution of the Eurosystem is also acknowledged.

As for the publication of its financial stability reports, the ECB produces once a year a comprehensive financial stability review, whose main objective is to provide a review of risks and sources of vulnerabilities relating to the euro area/EU financial system. In addition, regular updates are produced on main risk to financial stability, covering the same scope as the annual review, while being focused on recent changes. These documents support an assessment of financial stability by the ECB Governing Council. They are also shared regularly with relevant EU bodies and international fora. Whether or not it is appropriate for the ECB to publish either regular broader reports on financial stability or a financial stability review is an issue that could be examined by the Executive Board and the Governing Council.

Finally, as for the statutory responsibilities of the Eurosystem in the fields of banking and financial supervision and its advisory functions, they are provided by Article 105 of the Treaty and the ECB/ESCB Statute. In particular, the Eurosystem has the task of contributing to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. On the other hand, the ECB must be consulted on any draft Community and national legislation in the fields of banking supervision and financial stability, and can

propose, on its own initiative, advice on the scope and implementation of the European legislation in these areas.

With regard to the conduct of banking supervision in the single market, the basic principles of home country control and mutual recognition have been effective, also favouring significant progresses towards integration. An integrated market does not necessarily call for centralised supervision or absolute uniformity of rules; on the contrary, some degree of regulatory competition may prove healthy. However, it has to be recognised that excessive discrepancies in national rules are costly to banking and financial organisations.

C. Functioning of the ECB and other questions

12. How do you perceive the internal balance and the repartition of functions and roles between the different members of the Executive Board, and in particular, the President, the Vice-President and the Chief economist of the ECB?

The President of the ECB has been assigned the specific responsibility of chairing the Executive Board and the Governing and General Councils according to Art 13 of the Statute of the ESCB and the ECB. The same Article also refers to the same responsibilities for the Vice-President acting on the President's behalf in the event of his absence. Article 11.6 of the Statute states that the Executive Board is "responsible for the current business of the bank". This means a collective and collegiate responsibility. To organise matters efficiently, Article 10.2 of the Rules of Procedure of the ECB recognises that, while all work units of the ECB are under the management of the whole Executive Board, individual responsibilities are allocated for certain activities with a view to achieving a degree of burden-sharing and some division of labour. The Executive Board collectively decides, with the explicit consent of the President, which Executive Board member prepares decision-making for which specific functions and who oversees and guides the work required by the ECB staff for this preparation. I think that this is a very sensible solution which has worked well in the past. I expect it will also work well in the future.

One member of the Executive Board is particularly responsible for Economics and Research, and it is this member who you refer to as the "Chief Economist". In my personal opinion, this assignment does not prejudice the collective management of the ECB which is exercised by the Executive Board, and the collective economic diagnosis and decision-making on monetary policy which is performed by the Governing Council, composed of the six members of the Executive Board and the twelve National Central Bank Governors. Following those Governing Council meetings which are devoted to monetary policy, the President of the ECB acts as the spokesman and makes public the views of the Council.

13. Shouldn't the different responsibilities of Board members change with time, in line with the changes occurred in the ECB's tasks and priorities?

As a member of the Board of the Bank of Spain, I am aware that the Executive Board has reviewed the issue of its functioning and its role in the management of the ECB, and has

explicitly provided that individual Executive Board members should not only guide the work of individual business areas, but also be responsible for a number of cross-organisational functions and tasks.

Personally, I too would find it natural for Executive Board members to change some of their activities during their eight-year term of office. This makes even more sense in the light of the collegiality principle mentioned above. Another reason for the rotation of responsibilities among Executive Board members is the very fact that ECB tasks and priorities themselves may change over time. For instance, the role of the ECB in financial stability issues, the significance of EU enlargement for the ECB and the management of the ECB's human resources are examples of tasks that have evolved considerably over the last six years. Whether or not the same Executive Board member should continue to take care of the changing content of a certain issue remains for the Executive Board to decide at the appropriate point in time.

14. What challenges do you think the ECB's monetary policy will face during the preparation of Euro entry by the accession countries and after their entry? What is your opinion regarding the pace at which the accession countries should join monetary union and adopt the Euro, considering all of the convergence criteria and the participation in the exchange rate mechanism (ERM II)?

It is very important for the Eurosystem and, particularly, for the acceding countries themselves that the new exchange rate mechanism (ERM II) – and their participation in it – should function smoothly as a successful framework for achieving sustainable convergence. Not every country will be in a position to join ERM II from the outset. While all new Member States are expected to adopt the euro once they fulfil the Maastricht criteria on a sustainable basis, there is no single trajectory towards the euro that can be identified and recommended for all new Member States. The new Member States differ in their economic structure as well as in their exchange rate and monetary regimes and in the degree of nominal and real convergence that they have already achieved. This is why it is not possible to plot a single course that would be best for all the new Member States on their way to the euro area. This reasoning applies to the entire process of monetary integration, including membership of the exchange rate mechanism (ERM II), in which countries have to participate for at least two years prior to the convergence assessment leading to the adoption of the euro. The timing of entry into the mechanism, as well as the duration of participation, should also reflect what is best in terms of fostering macroeconomic stability in the new Member State concerned.

When choosing the pace at which the new Member States plan to join the euro area, countries should (and in fact do) consider what strategy towards ERM II and the euro enhances their prospects of achieving a lasting convergence of economic fundamentals. In this connection I would like to emphasise the importance of an overall sound policy framework for the success of ERM II participation. In particular, for participation in ERM II to be smooth, it is necessary that major policy adjustments be undertaken prior to participation in the mechanism and that the participating Member States pursue, where necessary, credible fiscal consolidation.

In any case, the ECB monetary policy strategy is well equipped to work also in an enlarged euro area. In particular, the aim of the ECB to maintain inflation rates below but close to 2% can easily accommodate some cross-regional inflation differentials that might emerge after the entry of the acceding countries into the euro area, without this meaning that regions with lower inflation rates would face periods of protracted decline in prices. It should also be considered that acceding countries' economies will account for only a small share of the enlarged euro area economy and that acceding countries will have to fulfil the convergence criteria before adopting the euro.

15. What is your opinion on the debate regarding nominal vs. real convergence, in terms of the eventual new Member States' entry into the Euro area?

The role of nominal convergence in the eventual adoption of the euro by the new Member States is clearly spelled out in the Treaty. The conditions that have to be fulfilled include an assessment of the sustainability of the degree of nominal convergence achieved. This assessment will be made, as in the past, on a case-by-case basis and taking into account the specific situation of each individual Member State.

Let me stress that nominal and real convergence far from constitute a trade-off. They are in fact complementary, and can and should be pursued in parallel. Real convergence, understood not only as the process of real income convergence but also as structural and institutional convergence, can support nominal convergence. For example, structural reforms that improve the supply side of the economy and enhance its competitive environment and its growth potential are in general conducive to lower inflation and interest rates. Conversely, by anchoring inflation expectations and providing a more stable macroeconomic environment, nominal convergence has a positive impact on trade and investment, thereby supporting real convergence.

In my view, the experience of the new Member States in recent years also points to the complementary nature of nominal and real convergence. While per capita income in the new Member States remains well below the average in the euro area, growth in the new Member States as a whole has been higher than in the euro area in recent years and is projected to remain so over the medium to longer term. This catching-up process has been taking place against the background both of progress in many areas of structural reforms and, simultaneously, remarkable achievements in the area of nominal convergence, in particular with regard to disinflation.

D. Democratic accountability and transparency

16. Could you elaborate on your views on the concept of democratic accountability with regards to the ECB and central banking in general?

Over recent decades central bank independence has become a key feature of monetary constitutions across the industrialised world. Substantiated by academic analysis and empirical experience, it is now generally recognised that central bank independence is conducive to the achievement of price stability. This, in turn, supports the achievement of other economic policy goals such as sustainable growth and a high level of employment. Moreover, independence enhances a central bank's credibility to keep inflation in check,

facilitating its task by orienting the expectations and behaviour of economic agents towards price stability.

At the same time, removing the policy decisions of a public institution from the sphere of political influence must go hand in hand with the establishment of strict accountability requirements. As the granting of independence to a central bank is ultimately a decision for the electorate, the central bank must be required to give account of its policy decisions to the public and their elected representatives, i.e. Parliament.

In my view, central bank accountability is the flip-side of central bank independence. Both are intrinsically linked and indissoluble. The current Treaty establishing the European Community provides for several institutional guarantees for both the ECB's independence and its accountability. This framework has been kept unchanged in the draft Constitution. The ECB's regular and comprehensive reporting on its policy decisions to the European Parliament therefore remains an essential ingredient of the EU's monetary constitution which, in my opinion, has , proved to work successfully in the interest of our citizens in recent years.

17. The ECB has long refrained from accepting the European parliament's request to publish the minutes of its Governing Council's meetings. What do you think are the impediments and inconveniences of such publications? Would you be in favour of the publication by ECB of the minutes of its Governing Councils meetings in the near-term future?

I am aware that the suggestion to publish the minutes of Governing Council meetings has been a subject of debate between the ECB and the European Parliament in recent years. Central banks' policies around the world diverge here and there is no accepted benchmark that would provide a conclusive, globally valid answer to this question.

For the euro area I believe that, after careful consideration, the arguments against the publication of minutes seem to prevail for a number of reasons.

First, it is worth noting that the institutional environment of the euro area, whereby the assignment of monetary policy competence to a Community body is not accompanied by a similar institutional set-up for economic and other policies, makes the euro area a unique construct, incomparable to any classical "nation state" in which central banks normally operate. This has a number of important implications. In particular, the Members of the Governing Council take decisions exclusively from an euro area perspective. At the same time, the Governors of the National Central Banks of the Eurosystem are appointed by the Member States and may, therefore, erroneously be perceived as the representatives of their respective countries in the Governing Council. Therefore, Governing Council Members need to be able to express their views without risking possible interference from national authorities or interest groups. The publication of detailed minutes would not be conducive to this objective.

Second, the provisions of Art. 10.4 of the ESCB Statute stipulate that the proceedings of the meetings of the Governing Council shall be confidential, while the Governing Council may decide to make the outcome of its deliberations public. The decision not to

publish Governing Council minutes but to release, immediately after Governing Council meetings, comprehensive press statements that provide a detailed account of the reasoning underpinning the ECB's monetary policy decisions, is fully in keeping with these Treaty provisions.

Third, the above-mentioned press statements present, in essence, the information that would normally be covered in summary minutes. However, in contrast to formal minutes which need to be approved and can thus only be published with some delay, the ECB's press statements are immediately available and thus provide timely explanations about the ECB's thinking. Given that the publication of formal minutes necessarily occurs with some delay, such publication may occur at a time when the economic and monetary environment may no longer correspond to the environment prevailing at the time when the policy decision to which the minutes refer was taken. In such cases the publication of the minutes would not provide correct guidance to markets and the general public and would confuse, rather than clarify, the understanding of monetary policy decisions.

That said, as a Member of the Executive Board, I would strive to ensure that the high standards of accountability and transparency remained an essential part of the ECB's policy framework.

18. What conclusions do you draw from the comparison between the transparency policies followed by the Federal Reserve Bank and by the ECB? What do you think about the publication by the Fed or the Bank of England of the minutes of their meetings? Do you think this policy could be applied by the ECB?

I attach a great deal of importance to transparency in monetary policy-making. I view it as a counterpart of the high degree of independence that modern central banks have – and rightly so- gained over the last, say, 15 years in many countries. In addition, transparency may increase the effectiveness of monetary policy, as it can provide guidance to the markets in forming expectations about the future conduct of monetary policy. I believe that the ECB has always tried to present policy decisions to the public in an honest and transparent manner that indeed accurately reflects the way these decisions are actually taken by the Governing Council. Because policy-makers face a complex and uncertain world, the honest approach to communication can often seem complicated. However, it is only by being honest about the difficulties that policy-makers face that the central bank can truthfully explain policy decisions and thereby achieve genuine transparency.

Having said that, I believe that there is no single way to achieve transparency. The ECB has chosen to hold a monthly press conference immediately after the Governing Council meeting conveying the overall discussion in the Council and the main economic arguments underlying the decisions. The Introductory Statement of the President and the possibility for journalists to address questions directly to the President and the Vice-President makes the ECB's approach to communication extremely timely and transparent.

A comparison of different approaches to transparency remains very difficult, mainly because different institutions might have different histories, policy objectives and institutional frameworks.

19. Don't you think that it is high time for the Executive Board of the ECB to enlarge the range of views and backgrounds within it? After 5 years of existence of the ECB, shouldn't we now broaden the scope of the Board, and not rely exclusively on central bankers?

I am personally very open in this respect. My own background and experience can be defined as a combination of academic, advisory and central banking activities. More importantly, the Treaty and the Statute are quite clear: Art. 11.2 of the Statute unambiguously states the requirements for qualifying for the Executive Board of the ECB as: 'recognised standing and professional experience in monetary or banking matters'. While it is not surprising that central bankers almost by definition fulfil these criteria, this by no means excludes a non-central banker from being appointed.

ANNEX 3

EUROPEAN PARLIAMENT

Committee on Economic and Monetary Affairs

Confirmation hearing of Mr José Manuel González-Páramo, candidate to be a member of the Executive Board of the European Central Bank

Meeting of Tuesday, 6 April 2004

OPENING STATEMENT

Madam Chairwoman, Members of the Committee on Economic and Monetary Affairs of the European Parliament, ladies and gentlemen: it is an honour for me to appear before you for this hearing. In my opening statement I am going to say a few words on three subjects. First I will focus on my career and experience. Then I will address a number of issues relating to the role of the European Central Bank. Finally, I will briefly comment on two of the main future challenges for monetary policy, namely enhancing the potential for growth and managing the enlargement of the European Union. I shall now switch to the language in which I feel most comfortable, my mother tongue.

It has frequently been said that the Executive Board of the European Central Bank needed to broaden the professional experience and profile of its members. I believe that the current composition of the Board encompasses a wide range of views, especially if account is taken of the requirements laid down in the Treaty on European Union and the Statute of the European System of Central Banks and of the European Central Bank. Nevertheless, perhaps my experience and career background - set out in detail in the written replies to the questionnaire previously sent to me by the chairman of this committee - can bring a new and different element. In fact, I am a professor of economics with a relatively broad background in central banking. Yet I can equally call myself a central banker with extensive academic and research experience.

I personally believe that these two facets can complement each other in a way that can bring great benefits. Monetary policy is both a science and an art. It combines methodological and scientific rigour with intuition and judgement moulded by experience. This judgement is given greater weight by the stamp of collegiate responsibility in the case of the independent central banks, as a result of the discussions and collective decision-making within their governing bodies. I think that both elements of my personal experience, as a central banker and an academic, offer a sound basis for fulfilling the tasks assigned by the Statute of the European System of Central Banks to the Executive Board of the European Central Bank.

Let me now move on to a brief account of my views on the role of the European Central Bank. The Treaty on European Union stipulates that the primary objective of the Eurosystem is to maintain price stability in the euro area. This is an objective which can be described as a 'public benefit', bearing in mind the accumulating objective evidence concerning the social

costs of instability and the experience of recent decades. The benefits of maintaining a low and stable inflation rate are well known. Price stability enhances the transparency of the mechanism for allocating resources in the competitive market; it minimises the interest rate risk premium, encouraging investment; it reduces monetary transaction costs; it alleviates the distortions generated by the tax system; and, among the other benefits it produces for a wealthy and cohesive society, it prevents arbitrary and undesirable redistribution of wealth and income.

My assessment of the achievements in the field of price stability in the years since the introduction of the euro on 1 January 1999 is highly favourable. The success achieved by the definition of stability at reduced levels, though sufficient to accommodate measurement distortions, inflation differentials and deflationary risks, and the framing of a monetary policy strategy geared to the medium term, cannot be over-emphasised. Despite the shocks that have affected energy prices and some commodity prices, as well as the exchange rate, inflation forecasts have been firmly maintained at low levels in the region of 2%. This is the product of well-designed strategic planning, based on the independence needed to achieve the objective of stability and adopt decisions, the structured procedure needed for the analysis of risks threatening price stability, the transparency needed to inform economic operators of monetary policy decisions and explain them, and accountability to European citizens and their legitimate direct representatives, the European Parliament.

Transparency and accountability are matters of constant concern and debate, as regards relations both with the European Parliament and other European institutions, particularly the Commission and Council, as well as with European citizens in general. My personal view is that the degree of transparency offered by the European Central Bank is highly satisfactory: monetary policy objectives are clearly defined and economically justified, while the way in which positions and decisions in this field are explained and announced is in line with best practice, with due regard for the institutional characteristics of the European Union.

This transparency, vital in ensuring the effectiveness of Eurosystem decisions, also serves the interests of accountability. The ongoing dialogue with the European Parliament and the requirements to report to the Commission and Council are a vital and necessary counterweight to the independence of the European Central Bank. This exchange of information and views can only help foster greater understanding of the challenges facing the European Union in its efforts to achieve sustainable growth, convergence, employment and economic and social cohesion.

I should like to conclude these brief remarks by touching on two of these challenges and their link with monetary policy. First of all, the inescapable objectives of enhancing sustainable growth potential and creating more and better jobs, within the framework of the Lisbon agenda. In order to meet these challenges it is vital for economic policies to inspire confidence and be geared to improving the market's capacity to adapt. The core of these initiatives consists of the structural reform policies for the goods, services, capital and labour markets, together with sustainable tax policies encouraging productivity and growth. In this connection, the best contribution monetary policy can make to sustainable growth and improved living standards is a firm commitment to medium-term price stability. This is a conclusion which enjoys sufficient objective justification and which, happily, is reflected in the letter of the Treaty on European Union. The aim is to maintain the value of the currency

and thus help to secure growth and employment.

Secondly, we are faced with the imperative of extending our frontiers to embrace ten new members of the economic and monetary union. This historic process, which will formally begin just over a month from now with the enlargement of the European Union on 1 May 2004, is rich in opportunities, but will also pose challenges as regards real and nominal convergence. The most important of these will be to determine how quick the transition to the single European currency should be in each case. The experience of most of the accession countries reveals a high level of complementarity between nominal convergence and the progress of real growth rates, sustained by structural reforms and progressive tax consolidation. Progress towards adoption of the euro must entail a period of exchange rate stability, together with efforts to achieve price convergence and to reform public finances that will undoubtedly be demanding. Nevertheless, recent progress offers grounds for hope that the future accession of new members to the Eurosystem will bring all the benefits of the single European currency.

Lastly, I should point out that the extension of the euro's frontiers will also provide the common monetary policy with a challenge it cannot overlook, namely the need to continue conducting a monetary policy geared to price stability in the context of an economic situation marked by greater heterogeneity among countries. In this respect, the threat to the maintenance of price stability cannot be overstated, once it is recognised that some of these disparities are inherent to the approximation process and will lessen once the sustainable nominal convergence criteria have been met and the single currency joined. Nevertheless, preventing the emergence of price tensions, as well as possible transitory phenomena related to the catching up process, will be largely a matter for the countries themselves, since fiscal imbalances and other structural rigidities are a major source of inflation rate differentials. These measures, together with a reform of the decision-making mechanisms within the Executive Board of the European Central Bank to ensure efficient and appropriate decision-making, offer grounds for taking an optimistic view of the future of the euro in an enlarged European Union.

Thank you for your attention.