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EMU: the first decade

Successes and challenges

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Editorial

Klaus Regling

Dear Reader

As we celebrate the first decade of Economic and Monetary Union (EMU) we should remember that the launch of EMU and the euro ten years ago marked a watershed in European integration. It transferred a core element of national sovereignty – monetary and exchange rate policy – to EU level, with far-reaching economic and political ramifications. For the international monetary system it was the most significant change at least since the end of the Bretton Woods system in the early 1970s. To mark this anniversary, the Commission has produced a report on the first ten years of Economic and Monetary Union that looks at its successes so far and the challenges it faces as it goes forward into its second decade in a changing global context.

One major success of EMU is the distinct improvement in the macroeconomic environment in the euro area as a whole. Since the start of EMU, inflation has been around 2% a year, significantly lower than the average 3.3% in the 1990s, and far below the levels of the 1970s and 80s when average inflation over the decade stood at 9.3% and 7.5% respectively. And even though countries in the euro area have recently seen significant increases in inflation, the euro has to some degree protected its member economies from the worst effects of global increases in food and energy prices.

At the same time, interest rates have fallen to levels not seen for several decades, while intra-European currency crises have been consigned to history. The EMU policy coordination framework has also helped euro-area governments get their public finances in shape, which is key to ensuring that this stability is maintained over the longer term and that national budgets can cope with the burden of ageing populations.

Employment has been another of the success stories of the euro area's first decade. Sixteen million new jobs have been created since the launch of the single currency while unemployment has fallen to its lowest rate in more than 15 years. Much of this progress is owed to the reforms undertaken under the Lisbon Strategy for Growth and Jobs, the economic policy surveillance and coordination within EMU, and the wage moderation that has characterised most euro-area countries. Moreover, the euro has certainly supported a closer integration of markets, such as for products and financial services. It has encouraged trade within the euro area and helped make EU firms more competitive.

However, more needs to be done in the area of structural reforms. While much was achieved in the preparations for EMU, structural reform efforts since its launch could have been more ambitious: one reason why our productivity growth – and per capita income – remains well behind that of the US. It may even be that the very success of EMU in providing macroeconomic stability has reduced the pressure in some Member States to implement structural reform. Unreformed wage- and price-setting systems in some euro-area countries have contributed to persistent pockets of high unemployment and substantial inflation differences between countries. And the integration of the euro-area economy is unfinished work across all sectors – goods, services and finance – this raises costs and the risks in a financial crisis. Finally, while the euro is gaining a reputation for strength and stability on the international scene, politically the euro area is punching below its weight as it has yet to speak with one voice, and does not have a clearly defined international strategy.

In addition, the euro goes forward into its next decade in an economic setting which is becoming more difficult worldwide. Against a background of globalisation, global current account imbalances and rapidly ageing populations, there is a clear need to boost productivity and further increase employment to provide a basis for higher living standards and sustainable public finances. Europe also needs more flexibility – for example in wages and prices – to improve the capacity to adjust to external disturbances. Rising commodity and energy prices around the world will put pressure on the stability and the quality of public finances, both of which will need careful attention to protect the social safety nets that are the cornerstone of the European social models.

To meet these challenges, the report proposes a three-pillar agenda covering domestic, external and governance issues. On the domestic front, broader and better policy coordination and surveillance is proposed to reduce divergences, including more intensive surveillance of candidate countries for euro adoption and a deepening of budgetary surveillance to ensure that fiscal behaviour does not cause overheating but supports sustainable finances over the cycle. Externally, the euro area's international role must be enhanced in line with the international success of the euro – eventually this would mean a single euro-area representation in international organisations. On governance, the report calls for the strong involvement of all Member States in the ECOFIN council as well as more active and vocal Eurogroup support for structural reforms.

On balance, it is clear that EMU has been a great success. It remains a milestone in European integration and this is reinforced as the newly acceded Member States prepare their economies to adopt the euro. A strong EMU also fosters the EU's standing in the world, and a well-functioning euro area forms the foundation for a strong external role for the Union in the global economy.

This landmark date for EMU is also one for me, as I leave DG ECFIN after seven years as Director-General. Having worked on the preparations for EMU and the launch of the euro in Germany, it was a great opportunity for me to move to the European Commission to shape the implementation and development of its operational framework. Its first decade has seen some challenging times, particularly concerning the implementation of the Stability and Growth Pact before its reform in 2005. However, it has also been very gratifying to see progress in the functioning of EMU, to see it develop at the international level as the euro area has increasingly come to be seen as a single economy, and to see the Commission's role in EMU grow. And although I will not be in such a hands-on role, I will of course continue to follow developments in EMU and the euro area very closely from the very different perspective of the National University of Singapore, where I will be the 'EU fellow' during the next academic year.

Thank you for your interest in DG ECFIN's work over the last few years. It only remains for me to say goodbye, and to hope that the next decade will be as rich in achievement for EMU as the last.

Klaus Regling
Director-General,
Economic and Financial Affairs DG

What's new

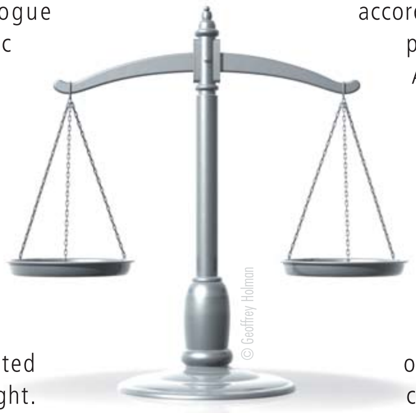
The latest topic du *jour*…

… is how Commissioner Joaquín Almunia, speaking at the Crans Montana Forum in Brussels on 2 April, described the heightened interest in and concern about the so-called 'sovereign wealth funds' set up by cash-rich countries, such as oil producers, to invest in assets abroad, and in particular in Western companies. And global imbalances have helped give these investment vehicles a higher profile, said the Commissioner, as shown by the emergence of Russia's Reserve Fund and the $200 billion worth of investments by the China Investment Corporation. The IMF estimates sovereign fund assets could rise to $6-10 trillion within five years. The danger, explained the Commissioner, is that because these funds are owned by states, not private companies, they could fuel a protectionist backlash as countries seek to protect their industries from foreign government influence. For this reason, the EU has adopted a coordinated approach to these funds that focuses on good governance and transparency and fully supports IMF efforts to develop a code of conduct to this end. For more information see the Commissioner's website.

http://ec.europa.eu/commission_barroso/almunia/index_en.html

Preserving price stability

In his regular dialogue with the Economic and Monetary Affairs Committee (ECON) of the European Parliament on 26 March, ECB President Jean-Claude Trichet predicted that the current period of relatively high inflation rates will be more protracted than previously thought. He emphasised the need to prevent excessive price- and wage-setting stemming from current inflation rates. "This is key to preserving price stability in the medium term and thereby the purchasing power of all euro-area citizens," he said. In discussing financial stability and money market supervision more generally, the ECB President called for a significant change of culture at national, European and global level to bring more transparency to markets, thus reducing 'contagious behaviour' and more 'anticyclicality' to avoid amplifying booms and busts. For more information see the speeches and publications sections of the ECB website.



Spring forecast

Economic growth in the EU is expected to ease from 2.8% in 2007 to 2% in 2008 and 1.8% in 2009, according to the Commission's spring economic forecast released on 28 April. In the euro area, economic growth is forecast to slow down from 2.6% in 2007 to 1.7% in 2008 and 1.5% in 2009. The new growth forecasts shave half a percentage point from the Commission's previous forecasts given six months prior. Following rapid increases in food and energy prices, consumer price inflation in the EU is expected to rise temporarily to 3.6% this year from 2.4% in 2007. The inflation rate is expected to fall back to 2.4% in 2009. The euro area's inflation rate is forecast at 3.2% in 2008, and at 2.2% in 2009, compared to 2.1% in 2007. "The EU economy holds up relatively well due to sound fundamentals. It cannot, however, escape the global shocks unaffected," the Commission stated.

A successful euro changeover

The final steps in the euro cash changeover in Malta and Cyprus were smooth and efficient, according to surveys of the local populations on the two islands. And vigilance by the authorities kept prices, and perceptions of price rises, in check, even though both countries are experiencing the background of rising energy and food prices seen elsewhere. These findings are set out in a Commission Communication of 18 April that evaluates the changeovers and draws lessons for the future. Both the Maltese and the Cypriots adapted swiftly to euro cash and the authorities took a very active approach to countering fears of price abuses – in fact, Malta is the first country where rounding up of prices on conversion into the new currency was forbidden by law. A Eurobarometer survey in February found 84% of Maltese and 55% of Cypriots reporting that price conversions were always or mostly fair, and in both countries more than nine out of ten citizens felt well informed about the euro.

Strengthening headwinds

The March issue of the Quarterly Report on the Euro area (QREA) from DG ECFIN confirms the lowering of growth forecasts while pointing out that the euro-area economy is showing resilience. It then goes on to look at why growth and inflation have become more stable in industrialised countries in recent years – a phenomenon known as the 'Great Moderation' – and shows that while labour market reforms are increasing employment, there is a growing divide where the burden of reform falls disproportionately on those without standard labour contracts. Other topics covered in the report include the diverging response of Member State economies to inflationary pressures, and the lessons for the East Asia region from Europe's experiences with EMU.

Juncker: euro area needs to address fairer wealth distribution

On 7 April the ECON Committee met the Eurogroup President Jean-Claude Juncker for their first exchange of views this year. Juncker noted that the economic fundamentals of the euro area remained solid and had proved resilient thanks to past structural reforms. The Eurogroup agreed that there was no need for recovery programmes in the euro-area Member States, he said. Past experience showed that such programmes were fruitless in the long term. Juncker said current statistics indicated that all euro-area Member States had fiscal deficits below 3% of GDP in 2007 and that the average fiscal deficit was at its lowest level since 1970s. The data still had to be validated by Eurostat at the time. Juncker opined that, at 7.1% in the euro area, unemployment was still too high and there were 15 million people living below the poverty threshold. He said some governments needed to address a growing feeling in the euro area that there was a socially unfair distribution of wealth with a growing group of "working poor".

The ECB celebrates

The European Central Bank celebrated its tenth anniversary on 1 June, when guided tours for the public were conducted at the Eurotower.

EUROPEAN CENTRAL BANK
THE FIRST TEN YEARS

The anniversary was marked the next day with a celebration involving the Eurogroup, music from the Chamber Orchestra of Europe, and speeches by European Parliament President Hans-Gert Pöttering, European Council President Janez Janša, and European Commission President José Manuel Barroso, topped off by an address from Angela Merkel, Chancellor of the Federal Republic of Germany. To mark the occasion – and achievements over the decade – the ECB is making a retrospective of central banking in Europe over the past ten years available on the ECB website.

Better access to finance for SMEs

Together with the Directorate-General for Enterprise, DG ECFIN is launching a series of 'EU Finance Day for SMEs' information events to be held in all Union Member State capital cities in 2008-2009. There are over 23 million SMEs in the EU and they employ 75 million people, making them the backbone of the Union's economy. Yet difficulty in accessing suitable types of finance, such as equity, bank loans or micro-credits, forms one of the major barriers to their growth and success. For this reason, the European Commission is providing over €1.1 billion as part of the Entrepreneurship and Innovation Programme 2007-2013. This amount is used both for funding guarantees to financial intermediaries across the EU, such as investors and banks, to encourage more lending to SMEs, and for investments in venture capital funds that provide equity or quasi-equity to SMEs in their seed, start-up or early expansion stages. The instruments are part of the Competitiveness and Innovation Framework Programme 2007-2013, and their day-to-day operation is managed by the European Investment Fund under the responsibility of the Enterprise and Economic and Financial Affairs DGs on behalf of the European Commission. The first event was held in the Slovenian capital, Ljubljana, on 28 March. For more information see the SME finance day website.
http://www.sme-finance-day.eu/

Regions with much to share

Asian portfolio investments in Europe grew 90% from 2001 to 2006, while European assets invested in Asia more than tripled over the same period. Both stand at about $1 trillion now, Haruhiko Kuroda, President of the Asian Development Bank (ADB), said at a conference in Brussels on 10 March. Given the importance of the two-way portfolio investments, the European and Asian Integration Achievements and Challenges conference brought together leading policy-makers, international experts and academics. "Our two regions have much to share," said Kuroda. "We both follow an incremental step-by-step, pragmatic approach to integration. And while Asia lacks the grand plan for regionalism as you have in Europe, the European Commission and ADB can effectively work together and use our distinctive expertise to add value to economic co-operation and regional integration more generally." Commissioner Almunia noted that Europeans are committed to countering protectionist sentiments that would be so costly to European and world prosperity. The one-day event was jointly hosted by DG ECFIN and the ADB. The conference documents can be found in the 'events' section of the DG ECFIN website.

São Paulo, Brazil

The euro in São Paulo, Brazil

'The euro: international implications and relevance for Latin America' was the title of a conference held in São Paulo on 17-18 March. Commission President José Manuel Barroso gave a keynote speech (in his native Portuguese). Participants heard from a number of European and North and South American economists on the ups and downs of EMU, the challenges it faces, and the lessons for other global regions, Latin America in particular. In his concluding remarks, DG ECFIN Director-General Klaus Regling stated his belief that the euro's international stature would continue to grow, although the pace at which this would occur was not known. "In the Commission we are fairly relaxed about this." However, he said, "I do not believe that the euro or any other currency will replace the US dollar. Rather, I expect the emergence, over the next decade or two, of a multi-polar international currency system."

A single voice for Europe

Commissioner Joaquín Almunia attended the G7 meeting as well as the spring meetings of the IMF and the World Bank, which took place in Washington, DC on 12-13 April. The overarching topic was the impact of the financial turbulence on the economic outlook and the policy responses to it. At the IMFC, ministers agreed to a compromise on quota and voice reform (see statement by the Commissioner to the IMFC). To ensure the legitimacy of Europe in these institutions, further reforms are needed and should include a consolidation of the European chairs, *in primis* at the IMF, as the Commissioner stressed in a speech he delivered at the Peterson Institute for International Economics in the US.

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Turbulent times call for reforms

This was the message Commissioner Joaquín Almunia gave to the OECD conference on 'structural reform in Europe', on 17 March in Paris. "In the current deteriorating climate, we urgently need to increase the reform momentum to limit the effects of a temporary slowdown," he told the audience, and called for more coordinated reform efforts that could help public acceptance. "Reforms work", he continued. "They have helped support the economic recovery of the last two years and they are now helping us weather the more turbulent times". So stepping up reforms just as they are beginning to deliver results would be the best possible response to the storm clouds gathered over the global economy" was his conclusion. For more information see the Commissioner's website.

Public Finances in EMU

On 11 June the Commission issued its ninth annual 'Public Finances in EMU' report. This analyses recent budgetary developments and assesses the outlook over the coming year, for both the euro area and the EU, and the individual Member States. It examines developments in the Union's fiscal surveillance framework, specifically concerning the assessment of the structural budget balance and the measurement of the quality of public finances. It also includes monographic contributions aiming to set out a comprehensive framework bringing together the different yet interlinked dimensions as well as providing some initial empirical illustrations. The main policy messages that can be drawn from the report are the subject of a Commission Communication issued at the same time.

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EESC: a time for assessment

The European Economic and Social Committee's Conference on 'Advantages and benefits of the euro: time for assessment' took place in Brussels on 14-15 April. EESC President Dimitris Dimitriadis welcomed the successes of the euro and added that the single currency's path should lead to further economic and social integration. Commissioner Joaquín Almunia and Deputy Director-General Marco Buti took stock of the first ten years of the euro and put into perspective the numerous challenges the euro area would face in the future. Commissioner Almunia invited the EESC to take an active role in the debate that would follow the release of the EMU@10 Communication. Speaking on the same day, Eurogroup President Jean-Claude Juncker deplored the lack of progress towards a unified representation of the euro area in international financial institutions, while ECB Board Member Jürgen Stark stressed that the ECB's clear mandate and full independence had been crucial to ensure price stability in the euro area. More on the EESC website.
http://eesc.europa.eu

ECB annual report

The ECB presented its 2007 annual report to the EP's ECON Committee on 21 April. ECB Vice-President Lucas Papademos also reported on the different activities of the European System of Central Banks and on monetary policy in 2007, and presented the ECB's response so far to the financial market turmoil. Papademos called for the EU to further increase the co-operation and exchange of information between central banks and financial market supervisors. He warned of the risk that "current temporarily high annual inflation rates, which may persist for a rather protracted period of time, could have second-round effects on wage- and price-setting". For more information see the speeches and publications sections of the ECB website.

Food for thought

In a Communication published on 21 May, the Commission put forward proposals for tackling the challenge of rising food prices. With input from several DGs, including DG ECFIN, the Communication notes that food price inflation reached 7% in March of this year, at a time when consumers are also facing rising energy prices. Analysis suggests that high food prices are likely to persist for the medium term, hitting hard not only net food importers in the developing world, but also poorer European households. The Communication recommends actions such as price monitoring and suspending import duties, to mitigate short- and medium-term impacts. For the longer term, the sustainability of biofuel production should be addressed and more work encouraged on the improvement of crop yields. At a global level, an open trade policy and maintaining the EU's humanitarian commitments while seeking structural solutions through development policy are highlighted. The ECOFIN Council on 3 June further discussed the issue in preparation for the EU summit later in the month.

Celebrating EMU: and the winner is…

As part of the celebration of ten years of Economic and Monetary Union, DG ECFIN held an on-line vote where EU citizens could choose between competing designs for a 2-euro commemorative coin. More than 141 000 people from across the EU cast their votes for one of five designs on a specially constructed website between 31 January and 22 February 2008. The winning design by George Stamatopoulos, a sculptor at the Central Bank of Greece, with over 41% of votes cast, symbolises the fact that the euro is just the latest step in a long history of trade. Some 90 million of this commemorative coin will be issued by all euro-area Member States in 2009. All those who voted for the winning design were entered into a prize draw for a set of high-value collector euro coins; the winner, Michał Milewski from Poland, received his prize from Commissioner Almunia in Brussels.

Further information
The latest news and press releases from DG ECFIN are available at:
http://ec.europa.eu/economy_finance/index_en.htm

Brussels Economic Forum 2008

"Every reason to be proud"

The EU Commissioner for Economic and Monetary Affairs Joaquín Almunia started his opening address by underlining the special significance of this year's conference which coincides with the tenth anniversary of Economic and Monetary Union and the launch of the euro in May 1998.

He then went on to outline the main achievements of what he described as a "crucial stepping stone to ever closer union". From day one, he told the audience, EMU created a zone of macroeconomic stability and put an end to traumatising exchange rate realignments, noting that without the euro today, the present turmoil in financial markets would be placing enormous strains on euro-area economies with serious consequences for trade and investment. "We ought to recall this simple fact, for those who forget our past monetary turbulences," he reminded listeners.

Looking at the successes of EMU and the euro, he pointed to the improving fiscal situation, particularly since the reform of the SGP in 2005, and noted that, if the Council follows the recent Commission recommendations on Italy and Portugal, for the first time since 2002 no euro-area country will be in the excessive deficit procedure – the majority are either in surplus or have balanced budgets!

"And last but not least", explained Joaquín Almunia, "citizens have been among the first to benefit from EMU's achievements. Price stability has shielded more vulnerable groups from abrupt loss of purchasing power." He also pointed to the combination of enhanced stability, deeper integration and reforms that have had such a striking impact on the labour market, creating 16 million jobs over the last decade, which is substantially more than in previous decades.

Future challenges

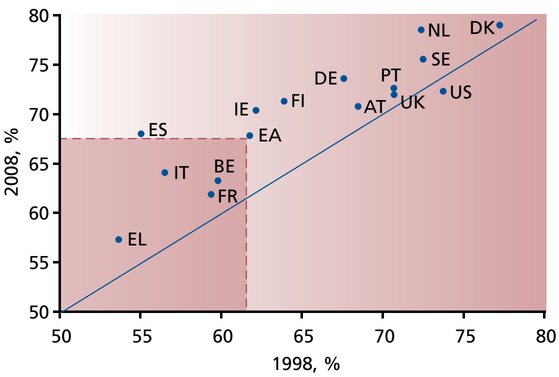
Looking ahead, the Commissioner warned that, while EMU has left the Union stronger, not all is positive. Economic growth is too low in some Member States, productivity growth is much lower than expected and there are persistent divergences between Member States of the euro area which pose risks for the ability of the bloc as a whole to adjust to economic shocks.

To address these and other challenges, the Commissioner proposed a three-pillar agenda for the future. The first 'domestic pillar' involves reinforced – broader and deeper – coordination and surveillance to quickly identify growing risks arising from imbalances and instability. The second pillar concerns developing a clear international strategy. The increasing role of the euro in international markets demands this. A global currency runs global risks so it is vital that the voice of the euro area is heard clearly in international fora. Moving to the third and final pillar, the Commissioner spoke on euro-area governance. Closer coordination between ECOFIN and the Eurogroup in particular will become more important as the euro area enlarges.

Commissioner Joaquín Almunia

Concluding, the Commissioner praised the decision of ten years ago to give the green light to EMU. "We are reaping the rewards of that truly bold decision," he said. "The euro is a huge success and we have every reason to be proud of our single currency."

Employment rate by country



Source: European Commission.

Brussels Economic Forum 2008

Economic and Monetary Union in Europe: ten years on

Organised by DG ECFIN, the annual Brussels Economic Forum (BEF) brings together EU leaders, economists and many other stakeholders to discuss major issues in European economics and economies. This year's BEF, held on 15-16 May, took the first ten years of Economic and Monetary Union as its subject, and the recent DG ECFIN 'EMU@10 report' provided the background context. The Forum was divided into three sessions. Session 1 assessed growth and employment in Europe after a decade of EMU, looking at policies, the euro in global financial markets, and whether it has lived up to its expectations. Session 2 considered how well the euro has weathered storms, and is doing so today, in the international environment. The final session looked to the future and asked how the full potential of EMU and the euro can be unlocked to give stronger growth.

Brussels Economic Forum 2008

EMU: looking forward to the next decade

The overall mood was one of resounding success as the Brussels Economic Forum got under way with its first session, 'Growth and Employment in Europe – Assessing Ten Years of EMU'. Figures past and present from the history of the euro came together to discuss achievements and unfinished business arising from EMU's historic first decade.

The tenth anniversary of monetary union provided the perfect opportunity to look back on the creation of the single currency, its successes and the work still to be done. The first session focused on the impact that the euro has already had and the prognosis for the future as we face challenges including environmental change, globalisation and an ageing population.

In his keynote address, Jean-Claude Juncker, President of the Eurogroup and Prime Minister of Luxembourg, was keen to sing the praises of monetary union and to stress its importance. The euro is "a political symbol of European integration," Juncker explained, "but it is not just a symbol, it is a shared objective". It is "an undeniable success", he said, which has been realised despite all of the claims that it was doomed to failure. He praised the vision of the EMU's pioneers who, despite objectors, remained unfazed and continued with their bold plans to create a new monetary union.

Accustomed to stability

All of the speakers touched on the euro's rocky path to inception, but commented that the doubters had been confounded. Tommaso Padoa-Schioppa, Italy's former Minister of Finance, praised the sense of normality that the euro has achieved, saying that "we only feel symptoms when we are in pain"; on which basis it can be concluded that the EMU is in good health. Wouter Bos, Deputy Prime Minister and Minister of Finance for the Netherlands, echoed this sentiment, saying that "We have become so used to stability that we have almost forgotten to look upon it as an achievement". He also pondered what might have occurred over the past ten years if the EMU had not come into being, painting an unhappy hypothetical picture of poorly controlled inflation and tensions between Member States.

An example of the positive effects of the euro for a Member State was presented by Spain's Deputy Prime Minister and Minister for Finance, Pedro Solbes, who said that the single currency is at the basis of the strong performance of the Spanish economy in the last several years. Malcolm Knight, General Manager of the Bank of International Settlements, explained the global impact of the creation of the world's new second currency, which continues to gain in acceptance and usage. Theo Waigel, former German Minister of Finance, praised the strength of the currency, saying "Ten years ago I said the euro will be as stable as the Deutschmark – and I was right!" Now he predicts that in the long run the euro could develop into an equal competitor to the dollar.

A member of the audience asked whether this is possible whilst the euro is the only currency in the world not backed by a single state. Joaquín Almunia, EU Commissioner for Economic and Monetary Affairs, believes that it is, as the ECB acts as a strong and independent central bank, and surveillance and economic coordination in the Eurogroup is getting stronger. Knight supported this view and highlighted the importance of euro-area-wide financial regulation and supervision, while Bos pointed out that the US is also a somewhat heterogeneous entity composed of over 50 diverse states.

Achieving its full potential?

The panel was not entirely unstinting in its praise for the euro, however, and there was discussion of the areas in which the EMU has not yet yielded all of its potential benefits. Growth has been robust, but not sufficiently so; employment is up and unemployment figures are down, but there is still room for improvement. And whilst deficit

"We have become so used to stability that we have almost forgotten to look upon it as an achievement."

Wouter Bos

levels are at their lowest for 25 years, public debt remains at far too high a level. Overall, Juncker argued, "the standard of living has not necessarily gone up enough" compared to the other changes. Summing up the situation, he said that there remains a "gap between our ambitions and our achievements", which must be closed.

The debate was broadened beyond purely economic affairs, as Waigel told the audience that it was important to remember that Europe was, and remains, predominantly a political project. "Europe must not be narrowed down to merchandise trade, currency and exchange rates," he said. Pervenche Berès, Chair of the European Parliament's Committee on Economic and Monetary Affairs, reiterated this point, warning against turning the euro into a tool for protection and forgetting that other policies, such as employment and social affairs, must run alongside it. As an active participant in designing and launching the euro area, Waigel judges the results of EU policies so far to have been somewhat mixed: on the plus side, human rights legislation and EMU have been implemented successfully, but Europe still lacks a common foreign and security policy.

Towards stronger governance

The session served not only as a retrospective, but also as a glimpse of what is to come. Session Chair Marco Buti, Deputy Director-General of DG ECFIN, set the tone in stating, "We are in forward-looking mode". A number of the speakers outlined key objectives to ensure the future success of the monetary union. Bos argued for stronger crisis management, tighter budgetary coordination between Member States, and greater accountability of EU spending. Berès applauded the euro's ability to protect the European economy but said that it could do more. "We are better as guardians of stability than as guardians of growth," she explained. The single currency should be used as a tool to boost the European economy as a whole.

Juncker argued that greater unity amongst the euro-area members, particularly in terms of having a single voice at international level, was vital for the continued success of the euro. Coordination is "easy in the good times, but harder when the going gets tough," something which must change if the euro-area members are to reap the long-term rewards. The Eurogroup is vital for this and Juncker expressed his satisfaction at the extension of its scope beyond purely budgetary matters to look at such issues as prices, wages and competitiveness, although their decisions on these areas have no binding effect.

The question of whether the Eurogroup should have greater powers, or even institutional status, was raised by a member of the audience during the panel discussion. Replying, Juncker said that it is important not to divide the EU into two camps: those who use the euro, and those who do not. At the time of its formation, the UK, Denmark and Sweden, which have not joined the euro area, were not keen on a formal role for the Eurogroup that might devalue the importance of the ECOFIN Council. Commissioner Almunia supported this analysis and pointed to the recent enlargements, which mean that several Member States will remain outside the euro area – in the near future at least.

Who dares wins

Of course, no one can be certain of what the future will bring. As Wouter Bos asked, "Ten years of the euro has been a success, but what will the next ten years bring?" Only time can really tell us, but what is certain is that EMU is in a strong position to meet both external and internal challenges, with the Commission's recent Communication on the EMU@10 showing the way.

A recurring theme of this session was that the EU is most successful when it strives for bold aims. "The EMU seemed impossible for some," said Juncker. "It is a success and we should be proud of it." It shows that "if Europe is brave enough, it is capable of doing great things".

A symbol of unity and stability

"Over 320 million Europeans from Nicosia to Helsinki carry euro notes and coins in their pockets, purses and wallets. The single currency is an immensely powerful symbol of unity, of stability and of confidence. The euro has more than proved its worth. The doubters have been confounded. The challenge now is to realise its full potential."

Commission President José Manuel Barroso on ten years of EMU.

Brussels Economic Forum 2008

The euro in the world

Session II of the Brussels Economic Forum explored the global position of the euro, charting its rise to international prominence, its current status, and the opportunities and challenges which lie ahead. Leading figures from the world of policy-making and finance were at hand to give their expert opinions and expectations.

The decade since the introduction of the euro has seen the single currency go from strength to strength, both as the national currency of its member countries and as an international currency of growing repute. In addition, the euro has not only made currency crises within Europe a thing of the past, but it has also successfully weathered the bursting of the dot-com bubble, the aftermath of the 11 September 2001 attacks and the major shifts in commodity prices.

Session II focused on a wide spectrum of issues related to the euro's international position and how Europe has steered and should steer it. It also explored the question of how well the euro will weather the current storm in the financial markets and how it could act as a stabilising influence in the future.

Growth multiplier and shock absorber

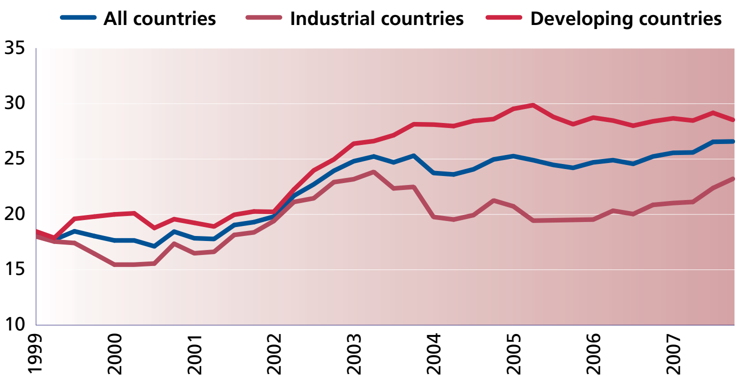
Dominique Strauss-Kahn, the managing director of the International Monetary Fund (IMF) and the French Finance Minister at the time of the launch of the single currency in 1999, kicked off proceedings. He began by recalling the challenges involved in laying the ground for the euro and allaying the fears of sceptics. "What we did back then was a piece of history, at least a piece of economic history," he stressed. "Now the euro is here and it works. The success is there to see." Among its successes, he listed, was how it facilitated travel, simplified trade, underpinned economic stability, helped to underwrite economic growth in the euro area, made financing cheaper and facilitated the creation of millions of jobs.

According to Strauss-Kahn, economic and monetary union has so far helped cushion the euro area against the volatilities of the global system. However, he expressed his view that the true extent of this resilience has not yet been put through its paces. "But perhaps it is being tested now by the sub-prime crisis." Looking to the future, Strauss-Kahn highlighted the importance for euro countries to have a "coordinated policy for dealing with external shocks".

Tackling the global turmoil

Stephen Roach, who chairs Morgan Stanley Asia, explored this question in detail. "We have just witnessed the biggest consumption binge in history," he said, referring to the US credit and property boom, "and we are now looking at several years of Japanese-like behaviour with sluggish and anaemic growth." Europe has no special dispensation from this crisis, he insisted. The only bloc capable of taking up the slack and supporting world growth is the EU. But he expressed his doubts that this would happen because EU growth is primarily driven by exports, which means that the euro-area economy cannot be immune to a US recession.

The euro as a reserve currency
% of allocated reserves



Source: European Commission.

Roach went on to talk about the next cycle, which he believes will be heavily influenced by the current debate on globalisation. "The US and the EU are not enamoured of globalisation," he said. "There is a risk of a major backlash against globalisation," he believes, "And this move to 'localisation' and protectionism poses a major threat not only to growth, but also to economic stability."

Taking a more optimistic view, Adam Posen, deputy director and senior fellow of the Peterson Institute for International Relations, argued that the worst was already over. He regarded recent events as a stress test for the euro, which it had passed with flying colours. This was partly thanks to the incisive action taken by the European Central Bank (ECB) to react to the liquidity crisis by not cutting interest rates and injecting liquidity into the markets. In addition, the euro has appreciated a lot without euro-area governments putting any excessive political pressure on the ECB to react.

Shoulder to shoulder

The euro's success as an international currency has confounded many, especially since it has been largely spontaneous and demand-driven. ECB Vice-President Lucas Papademos charted the impressive rise of the euro as a global currency over the past decade. "Over the past ten years, the euro has established itself as the second most important currency after the dollar. Its share is greater than its legacy currencies combined," he said. Among the wealth of statistics he presented, he noted that about a quarter of foreign exchange reserves in the world were now held in euro, while the single currency's share of international debt securities currently stands at about a third. On the home front, there have been plenty of benefits, too. "The efficiency of euro-area financial markets has increased significantly since the introduction of the euro," he continued, giving an example.

Asia, in particular, has taken to the euro with surprising enthusiasm. "In less than ten years, the

> **"The euro has evolved into an international currency that can stand shoulder to shoulder with the US dollar."**
> **Haruhiko Kuroda**

Left to right: Lucas Papademos, Dominique Strauss-Kahn, Haruhiko Kuroda, Adam Posen

euro has evolved into an international currency that can stand shoulder to shoulder with the US dollar," remarked Asian Development Bank President Haruhiko Kuroda. "Asia has been particularly interested to see how the euro has helped promote prosperity and financial security in Europe." Kuroda attributed the success story of the euro in Asia to the fact that Europe had become a more important destination for Asian exports, and the falling value of the dollar had prompted Asian entrepreneurs and traders to seek alternative currencies. And this trend is set to go on. "I expect that the euro will continue along its path as an alternative international currency to the US dollar," he forecast.

The efforts to promote convergence in the euro area are being watched closely in Asia, with economies of varying size and nature, and at different levels of development. "The euro has played an essential role in fostering harmony among diverse economies," he added. "This experience is extremely useful for Asia as the region moves ever more resolutely towards its own style of regionalism."

The future status of the euro as an international currency, Papademos argued, will depend on the relative size and stability of the euro-area economy.

The currency of the brave

Despite its obvious success, Strauss-Kahn believes that the single currency is punching below its weight globally. "The euro should be one of the pillars of the international financial system," he said. The IMF chief urged euro-area countries to coordinate their international policies more closely. "The question is not whether or not the euro area should have a single chair in international institutions; the point is to have a single policy and position." He expressed his belief that a single voice for the euro area would be good for both Europe and for global economic stability.

Posen echoed this point when he lamented the lack of coherent representation of the euro on the international scene. The euro is overvalued against the dollar because the Asian currencies have not adjusted, he explained. This, he believed, would not be the case if the euro area had added a clear, strong and united voice to that of the United States when they were discussing this problem with the Chinese. In short, Posen maintained, the reason the euro has not been more widely adopted as an international currency is simply because the euro area does not have an active foreign policy.

"As always with the EU, it is political will that will make the difference," Strauss-Kahn concluded. ■

Brussels Economic Forum 2008

Realising the full potential of EMU

The third session of the Brussels Economic Forum looked at how the euro area can be consolidated. Speakers considered issues such as economic policy governance, and the structural reforms needed to ensure the euro delivers growth according to its potential.

ECB President Jean-Claude Trichet

Reflecting on the success of the euro over the decade since its launch, Jean-Claude Trichet, European Central Bank President, emphasised that "the single currency has fully inherited the degree of credibility and confidence that was the privilege of the most credible national currencies before the euro".

Credibility has to be earned, however, and he underlined the need for the ECB's reputation to be forged over the long term, noting that "despite the different shocks the ECB had to cope with since its inception, prices have remained stable over this period, average inflation being moderate and inflation volatility being significantly lower in the euro area than it was before EMU".

Structural reforms

Trichet pointed to declining labour productivity growth, and by extension, to a slowdown in total factor productivity due to lack of technological progress and limited improvements in efficiency as critical in the euro area's competitive position. "The structural features of the economies in Europe do not incorporate appropriate incentives to invest in real and human capital, to innovate and to increase the flexibility of firms to smoothly and quickly adjust to their new environment," he underlined. Structural reforms are needed, to get more people into work, to increase competition and deepen integration – especially in the financial services sector, and in retail banking in particular, and to support innovation.

"The Lisbon Strategy is the tool to push forward ambitiously with structural reforms and improve the euro area's economic performance, and therefore consolidate the remarkable success of the euro," according to Trichet. In conclusion, he set out four "building blocks" to consolidate the success of the euro and strengthen the euro-area economy. First, the quality of the ECB's monetary policy, and its continued delivery of price stability in the medium term. Second, the Stability and Growth Pact, with the fiscal pillar of EMU the "key for the cohesion of the euro area". Third, successful structural reforms, through the "firm and courageous implementation of the Lisbon Strategy". Finally, he underlined the need for attentive monitoring of intra-area divergences in cost competitiveness, in particular in the area of unit labour costs in the civil service and public sector.

Political commitment

Mario Monti, formerly Internal Market and then Competition Commissioner, and now President of Milan's Bocconi University, raised concerns about the lack of political will and public support to make further progress in consolidating Europe's single market. He singled out recent initiatives in the fields of energy markets, the services sector and the Takeover Directive, where progress has been poor; and "what part of the single market could be more important for monetary union than financial services?" he asked.

The euro area's poor growth rates are down to the three largest economies, said Monti, naming no names he described them as "poor members of the euro area and of the EU". They tend to be behind in the integration of single market rules, and attract the largest share of infringement cases brought by the Commission. And they "determine the lack of progress in pushing the development of the single market". The poor euro-area economic growth rates, due to these countries, "underline the incoherence of 'not playing the game'", Monti emphasised.

Despite this, he pointed to positive signs. First, the Commission and the Court of Justice generally succeed in the end in ensuring that such national manoeuvres do not contravene single market rules, so "whilst there is economic nationalism, power is there to overcome it". Second, he identified several developments in the three countries concerned, which bring hope that each will strengthen their commitment to the single market. "We should all give support to renewed efforts on economic union", he pleaded, "as well as to pedagogical efforts to explain its benefits."

"Stronger action on fiscal and budgetary discipline is needed"

Guy Verhofstadt

Financial markets

Another former Commissioner, Erkki Liikanen, now Governor of the Bank of Finland, picked up on the need for stronger integration in financial markets, underlining that "the best way to guarantee a high level of financial services for EU citizens is to remove the remaining obstacles to competition". Moreover, financial integration would bring "better diversification of risks" as another benefit, provided that "we design appropriate regulatory and supervisory structures".

Competition is another area for attention. "Without well-functioning financial markets, economic power is in the hands of those who have liquid wealth, collateral and connections, not in the hands of those who have ideas," he emphasised. "This is the recipe for stagnation. Financial markets create the opportunities for newcomers to dislodge the incumbent, to leapfrog them by innovating." Liikanen also argued for greater steps to be taken to improve public sector productivity, but noted that measures have to be designed to take account of "outcome productivity" rather than the more easily measured "output productivity". In other words, public services need not only to be delivered efficiently but also effectively.

Lessons to be learnt

Portugal was a founder member of the euro area, but was one of the first members to endure a slowdown within EMU. Although Portugal had complied with the nominal convergence criteria to gain entry to the euro area, economic shocks threw up major challenges which could no longer be addressed with the old interest and exchange rate tools. The advent of the euro brought an illusion of "good times", delaying reforms, and secondly, with a minority government at the time, there was a lack of political support for reforms. "Ideally, countries should implement structural reforms before entering the euro area," Fernando Teixeira dos Santos, the country's Finance Minister suggested, although he conceded that Portugal could not have passed up the opportunity to join when it did, and pointed that joining the euro area was both a political priority and a successful means of achieving fiscal discipline.

Reforms are needed to boost euro-area productivity

Reunifying

One of the euro area's newest members, Cyprus, found peer pressure helpful in turning around the country's fiscal deficit, according to Michael Sarris, Cyprus's former Finance Minister, who stressed the importance of the debt criterion for stabilty in the longer term. He went on to emphasise the role that euro-area membership could play in the reunification of the island: "in political terms, it helps strengthen the common European vision of the two communities; and in economic terms, it sends a signal that the future reunified Cyprus would adhere to principles of sound macroeconomic management".

Economic policy coordination

Former Belgian Prime Minister Guy Verhofstadt called for the euro area to become a platform for stronger coordination in economic policy. The 'open method of coordination' (peer pressure, benchmarking and the sharing of best practice) exemplified in the Lisbon Strategy is "too soft", and so "stronger action on fiscal and budgetary discipline is needed". An "integrated budgetary framework for the euro zone" could make peer pressure stronger, encouraging members to agree between each other.

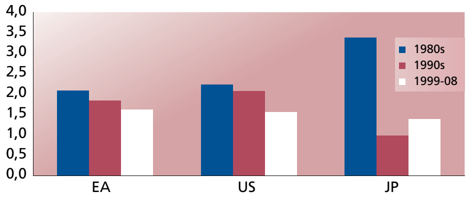
"The Eurogroup [of finance ministers from the euro-area countries] should become a real policy-making body, with discussions not limited to finance ministers". Verhofstadt wants to see these discussions expanded to other areas of economic policy and greater solidarity between euro-area members, for example when one country adopts a policy which may have effects on others.

The economy of the euro area

The euro area has proved over the past ten years to have been a successful and increasingly integrated economy. Today, in many respects, the euro area can be viewed as a single economic entity comparable to other very large economies.

In the last ten years the euro area has established itself as the second largest economy in the world. It already represents 16.7% of world GDP, second only to the US which has a share of 22.3% and well ahead of China and Japan, representing 10.3% and 6.9% respectively. With 320 million inhabitants, the euro area remains well behind China (1.33 billion) in terms of population size but is larger than the US (302 million) and Japan (128 million). The euro area has also replaced the US as the largest trading bloc on the international scene with a share of 16.4% of world trade, slightly above the US's 15.2% and well ahead of China (10.4%) and Japan (6.6%).

Graph 1: GDP per capita, euro area, US and JP
(y-o-y change in %; period average)



Source: Commission services.

Table 1 : Key economic indicators in the euro area, US and JP

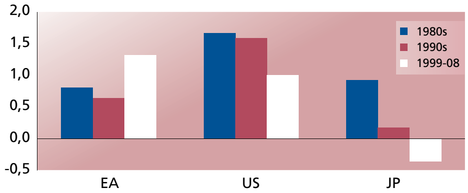
Key indicators 2007	Euro area-15	US	Japan	China
Population (millions)	320	302	128	1331
Share of world GDP (% at PPP)	16.7	22.3	6.9	10.3
Unemployment (% of labour force)	7.4	4.6	3.9	4.0
Share of world trade (% of goods excluding intra-EU trade)	16.4	15.2	6.6	10.4

Source: European Commission and IMF

A more dynamic picture can be provided by comparing the macroeconomic evolution of these areas in the last decades. After two decades of slightly lower growth of GDP per capita in the euro area than in the United States, the euro area has, since its launch, managed to match the US's performance, and exceed that of Japan, with an average GDP-per-capita growth rate of over 1½% per year.

As far as employment in the last decade is concerned, job growth in the euro area has outpaced that in other mature economies such as Japan, and even those with generally more favourable demographics, including the United States. In fact both the US and Japan have experienced a downward trend in employment creation unlike in previous decades. In the euro area, by contrast, almost 16 million jobs were created during the last decade. This massive growth in employment stands out as probably the most tangible economic achievement of the first ten years of EMU. In addition, labour market reforms have helped bring down the unemployment rate, which fell from over 9% in 1999 to 7% in 2008, although further efforts are still necessary to reduce it further.

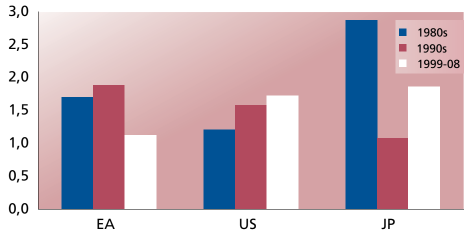
Graph 2: Employment, euro area, US and JP
(y-o-y changes in %; period average)



Source: Commission services.

The flip side of strong employment growth has been a sluggish productivity performance. Labour productivity growth has slowed to 0.75% in the euro area since its creation, well below the 1.75% recorded in the US. However, the relaunch of the Lisbon Strategy for Growth and Jobs should give new impetus to addressing the gap with the US. Moreover, it is important to note that economic research shows that the euro itself has made a positive contribution to productivity growth owing to scale economies, stronger competition associated with greater price transparency and higher investment amid lower risk and capital cost. Had it not been for the single currency, productivity in the euro area would have been even weaker.

Graph 3: Productivity, euro area, US and JP (1)
(y-o-y changes in %; period average)

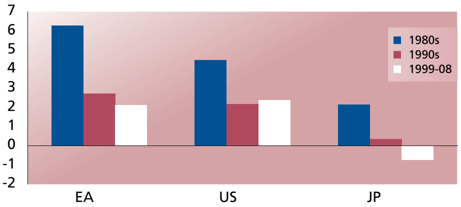


(1) The productivity is measured as GDP per person employed
Source: Commission services.

The euro as a pole of stability

The euro area has become a pole of stability for Europe and the world economy. A central achievement of EMU has been to anchor macroeconomic stability in the euro area. In contrast to the many separate economies that existed before 1999, if the euro-area economy today stands out for one thing it is its low-inflation environment that has nurtured stable economic growth over the past decade. Indeed, while inflation has fallen worldwide over the last three decades, this is nowhere more true than in the euro area. As graph 3 shows, inflation in the euro area has decreased markedly in comparison to previous decades. At the same time, it is striking how inflation has converged among the euro-area Member States. Much of this convergence occurred during preparation for the Economic and Monetary Union in the 1990s, which provided powerful incentives for national economies to reduce their inflation rates towards those of the best performing countries in Europe. Remarkably, the monetary policy of the ECB has fully succeeded in anchoring economic agents' inflation expectations, an an achievement which is particularly welcome in the current context of surging commodity prices.

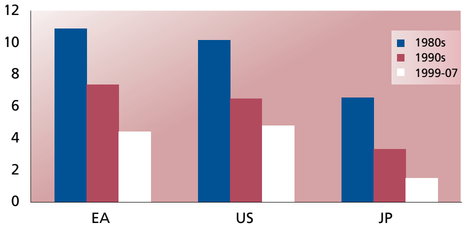
Graph 4: Inflation, euro area, US and JP (1)
(y-o-y change in %; period average)



(1) The inflation is measured using the price deflator of private final consumption expenditure
Source: Commission services.

The creation of the monetary union and the successful monetary policy of the ECB have also permitted a decade of low and stable interest rates. Falling interest rates have been a common trend in mature economies as graph 5 shows, but the decrease has been particularly remarkable in the euro area, with achieving also a good degree of convergence in the economies that joined the monetary union.

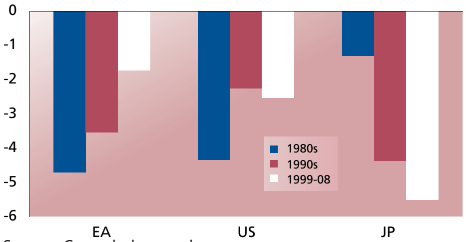
Graph 5: Nominal long term interest rate, euro area, US and JP
(in %; period average)



Source: Commission services.

Budget balances have also improved significantly in the first decade of monetary union. Budget deficits have declined significantly in comparison with previous decades, with the euro area achieving greater fiscal consolidation than the US, while Japan's deficit has considerably increased. The reform of the EU's framework of fiscal rules (the Stability and Growth Pact) in 2005 helped to achieve a renewed commitment to sound public finances which is paying off. The euro area has now achieved its best structural balances since 1973, which will be very important in helping its public finances cope with the challenge of an ageing population.

Graph 6: Budget balance, euro area, US and JP
(in % of GDP; period average)



Source: Commission services.

EMU and its stability-oriented economic policy framework have thus become a pole of stability for Europe and the world economy which, in the current international environment, is particularly good news. With the global economic situation and outlook unusually uncertain, the single currency has mitigated the negative effects of external shocks – as testified by the resilience of the euro-area economy in the face of the recent financial turmoil. Even during the highly turbulent period of the last few months, the euro area has contributed to an orderly evolution of the global economy with an external position in balance, a credible macroeconomic framework and a sound financial system.

The euro as a global currency

In the last ten years the euro has established itself as the second international currency alongside the US dollar, and its importance in the international financial system is likely to increase further. The euro's role as a trade invoicing or settlement currency has risen, reaching more than 50% of the euro area's external trade, while euro-denominated international debt securities have surpassed those of US dollars already since 2004. Likewise, the euro is the second most actively traded currency in foreign exchange markets worldwide and is used in more than a third of all foreign exchange transactions.

The new status of the euro as a major international currency has changed the rules of the game for the members of the euro area and for its international partners. It brings advantages to both the euro area and the world economy, such as the enhanced development of the euro area financial industry, which in turn makes global financial markets deeper and more liquid. There are also new responsibilities, related to the sheer size of the euro area in the world economy and the stabilising role that it is therefore required to play at regional and global level. This also brings risks, as the growing international status of the euro exposes the euro area to disruptive portfolio shifts between key international currencies and asset classes. In any case, the euro has become an important asset for the world economy and finds itself in a good position to rise to these emerging challenges and risks. This will however require a deeper involvement of the euro area in global surveillance and policy coordination.

Further information
More information can be found on the euro area pages on the DG ECFIN website:
http://ec.europa.eu/economy_finance/eu_economic_situation/eu_economic_situation186_en.htm

Slovakia's date with the euro

Slovakia has convincingly passed the first of the EU's tests for euro entry. Armed with the Commission's recommendation, it is well on the way to introducing the single currency, as expected, on 1 January 2009.

Bratislava: gearing up for the euro

The confirmation came on 7 May 2008, when the European Commission concluded in its regular Convergence Report on euro readiness that Slovakia now meets all the criteria for adopting the single currency.

"Slovakia has achieved a high degree of sustainable economic convergence and is ready to adopt the euro on 1 January 2009," said Economic and Financial Affairs Commissioner Joaquín Almunia.

The final hurdle facing Slovakia's bid will come in July 2008 when the EU's Economic and Financial Affairs Council (ECOFIN) convenes to consider the opinions of the European Parliament and EU leaders before making its final decision.

Rising star

Once it has ECOFIN's blessing, Slovakia is set to become the fourth of the ten Member States which joined the EU in 2004 to enter the euro area when it introduces the single currency on 1 January 2009. Slovakia will also become the 16th Member State to employ the euro as its national currency, enlarging the euro area to include more than 325 million Europeans.

For Slovakia, the imminent currency switch is not only about economic potential; many Slovaks will view the euros in their pockets as a vote of confidence and confirmation that their country is punching its weight on the European stage after the difficult post-communist years and the 'velvet divorce' which saw Slovakia and the Czech Republic go their separate ways.

"We were always considered the ugly duckling of Europe," one Slovak analyst observed, adding that Slovakia, which was seen as the "smaller, poorer brother" of the Czech Republic, has now become a "shining star" in Central Europe.

Surpassing expectations

Over the last few years, Slovakia has largely surpassed expectations. This may explain why it requested an assessment of its economic convergence from the European Commission and the European Central Bank, which normally occurs when a candidate euro-area country considers that its economy has moved close enough to those of the other members of the single currency.

The rules for economic convergence on which a candidate economy is evaluated were laid down in the Maastricht Treaty, which entered into force in 1993. All the Member States which joined the new euro area in 1999 had to meet the same criteria. The rules cover four main areas: inflation, government finance (deficit and debt), the national currency's exchange rate, and long-term interest rates.

Upon joining the EU in 2004, Slovakia pledged itself to the eventual adoption of the euro, and joined the exchange rate mechanism, ERM II, in November 2005.

Last year, Slovakia had set itself a general government deficit target of 2.9% of GDP, just shy of the 3% Stability and Growth Pact ceiling. According to the latest update, the deficit actually dropped to 2.2% in 2007, and it is expected to fall further, to around 2% of GDP, in 2008. But Slovakia's budgetary ambitions do not stop there. Its Convergence Programme foresees the deficit to drop to 0.8% of GDP by 2010 in nominal terms, with the primary balance improving from a deficit of 1.0% of GDP in 2007 to a surplus of 0.5% of GDP in 2010.

Moreover, the Slovak gross government debt, which hovers at around 30% of GDP, is about half the target level set by the convergence criteria (Graph 1).

Stabilising prices

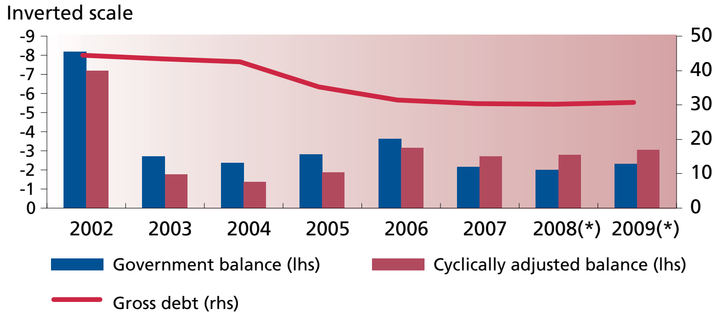
From pretty high levels when it entered the EU, Slovakia has brought its inflation level down

Tatra mountains in Slovakia

"To ensure that the adoption of the euro is a success, Slovakia must pursue its efforts to maintain a low-inflation environment, be more ambitious with regard to budgetary consolidation, and strengthen its competitiveness position."

Commissioner Almunia

Graph 1: Government budget balance and debt
(% of GDP)



(*) Commission services' Spring 2008 Forecast Source: Eurostat, Commission services

to 2.2% which is well below the convergence reference value of 3.2% (Graph 2). "The fulfilment of the inflation criterion is no one-day wonder, but the expression of a sustainable development," the head of Slovakia's central bank, Ivan Sramko, was quoted as saying.

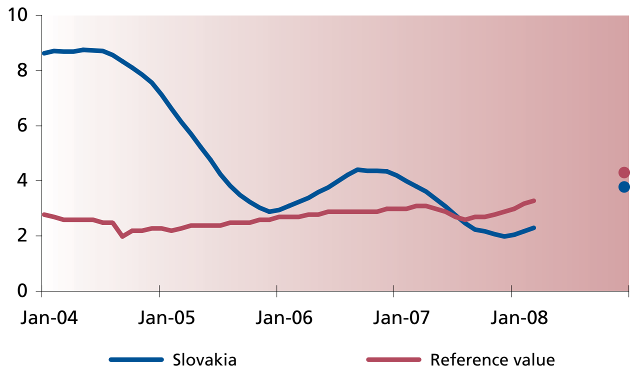
Although this level is low enough to allay worries about longer-term price stability, the Commission recommended Slovakia remain vigilant to keep inflation at a low level, notably by maintaining wage discipline, adopting a more ambitious fiscal stance and further advancing structural reforms to improve the functioning of product markets. "There's no reason for panic [about inflation rising] because there is no inflationary impulse from domestic Slovakian developments," the central bank chief insisted.

Slovakia's interest and exchange rates have also been satisfactory. The country's average long-term interest rate over the year to February 2008 was 4.5%, below the reference value of 6.5%. It has been below the reference value since 2004. Although the exchange rate of the Slovak koruna has risen quite strongly against ERM II's central rate, the Commission concluded that the reasons for this appreciation were sound and that the currency has not experienced severe tensions.

Despite the undoubted successes Slovakia has scored in preparing for euro entry in such a relatively short time, challenges will remain, even after it adopts the single currency. With the spiralling energy and food prices, maintaining budgetary discipline may prove tough in the coming years. In addition, these rising commodity prices, along with the rising cost of labour accompanying economic boom times, could well result in inflationary pressure on the Slovak economy.

"To ensure that the adoption of the euro is a success, Slovakia must pursue its efforts to maintain a low-inflation environment, be more ambitious with regard to budgetary consolidation, and strengthen its competitiveness position," Commissioner Almunia noted.

Graph 2: Inflation since 2004
(%, 12-month moving average)



Note: The dots show the projected reference value and 12-month average inflation in the country at December 2008

Sources: Eurostat, Commission services' Spring 2008 Forecast

The Slovak economy

In the 1990s, Slovakia experienced a less painful transition than many of its neighbours when it transformed its central command economy to a market one, following the collapse of the Soviet Union. The country was aided by its strong industrial base and reform-minded leaders, even though the rate of reform slowed somewhat following the country's 'velvet divorce' from the Czech Republic in 1993.

Building upon the economy's traditional foundations in heavy industry, Slovakia's key industries today are automobiles and electronics, both of which have attracted droves of foreign investors eager to take advantage of a cheap and skilled workforce, favourable tax rates and geographic location, and a relatively liberal labour code.

The substantial increases in FDI inflows to the country have also been encouraged by an accelerated reform programme which kicked in to prepare Slovakia for EU membership and, now, for the euro. This has included the restructuring of enterprises and banks, large-scale privatisation, as well as reforms to the tax, pensions, healthcare and welfare systems.

Slovakia is currently experiencing good economic times, which has helped it in its efforts to meet the convergence criteria. Its export-driven economy has enjoyed several years of sustained economic growth of up to 10.4% last year, boosted by the FDI inflows mentioned above and the resulting strong manufacturing growth. However, by 2009, real economic growth is expected to have declined to 6.2% according to the Commission Spring 2008 Forecast.

Strong growth and newly built export production capacities – such as new car production plants – are helping to improve employment levels.

Further information

More information on the Convergence Report can be found at:

http://ec.europa.eu/economy_finance/thematic_articles/article12550_en.htm

Looking ahead

For your diary

27 June 2008, a DG ECFIN workshop in Brussels

Ireland's economic transformation – miracle or model?

This event is being held to review the sources of the Irish economic 'miracle', with a view to better understanding the challenges that must now be faced if the gains of the past are to be secured. The seminar is part of a broader series of seminars focusing on the economies of EU Member States, organised by DG ECFIN. It will be attended by academics/professional economists working in Ireland and abroad as well as senior policy-makers in both national and EU institutions.

4-5 September 2008, ECB conference in Frankfurt

Household finances and consumption

A joint conference organised by the ECB and the Centre for Financial Studies (CFS) will be held at the Johann Wolfgang Goethe University in Frankfurt. The aim of the conference is to present state-of-the-art empirical and theoretical research on household asset accumulation, debt and consumption behaviour over the life cycle. The conference will include plenary talks by distinguished academics and central bankers. For more information see the CFS website: **www.ifk-cfs.de**

September 2008, a euro conference in Slovakia

EMU governance and euro changeover: Slovakia on the path to the adoption of the euro

Hosted by the government of Slovakia with support from the Commission and the ECB, this conference will look at the policy challenges for the management of EMU at national and EU levels. Workshops will consider the practical aspects of the changeover to the euro, including the preparations, the euro and inflation, and the advantages for business and consumers. Speakers will include DG ECFIN staff.

16-17 October 2008, the DG ECFIN Annual Research Conference, Brussels

Boosting growth and productivity in an open Europe: the role of international flows of goods, services, capital and labour

This fifth annual research conference will consider how globalisation and enhanced EU integration have affected the size and direction of flows of goods, services capital and labour, particularly in the EU and the euro area. Micro and macro perspectives will be presented with a broad geographical coverage that includes the recently acceded Member States. The key questions for the conference are to investigate how international flows affect European growth and productivity, and to identify policy options.

20-21 October 2008, a conference in Prague

The market for retail financial services: development, integration and economic effects

This 11th conference of the ECB-CFS (Centre for Financial Studies) research network on Capital Markets and Financial Integration in Europe will be hosted by the Czech National Bank in Prague. Conference topics include the evolution of retail finance, the integration and regulation of financial retail services, and their real effects, for example on growth, innovation and industry dynamics, including SME financing. The governor of the Czech National Bank, Zdeněk Tůma, will give a keynote address and ECB Vice-President Lucas Papademos will chair a session on the further integration of banking supervision. For more information see 'events' on the ECB website: **www.ecb.int**

St. Vitus Cathedral in Prague

22 October 2008, a one-day workshop at DG ECFIN

What drives inflation in the new EU Member States?

High inflation has emerged as one of the major economic challenges in several Member States over the past few years and for some it is the main obstacle on their way to the euro. This workshop will investigate the drivers of inflation in the catching-up economies of the new Member States, which can be relatively complex. Contributions to the workshop will address: external versus domestic drivers of inflation, catching-up and transition-related inflation, and the role of macroeconomic and structural policies.

13-14 November 2008, a DG ECFIN workshop in Brussels

Five years of an enlarged EU – a positive-sum game

This event is being held to mark the fifth anniversary of the accession of ten new Member States. Organised together with the Bureau of European Policy Advisers and DG Enlargement, this workshop will provide insights into the functioning of the enlarged Union and the impact of the enlargement on older and newer Member States. Trade, investment, migration and financial-market-related issues will be covered.

Further information
http://ec.europa.eu/economy_finance/events/

Commission agenda

June 2008

The European Commission will release the second 2008 Quarterly Report on the Euro Area on 24 June. The report will review the main messages of the Commission communication on 'EMU@10 – Report on the first ten years of Economic and Monetary Union' and of its accompanying Staff Working Paper. It will discuss the achievements of EMU, including low inflation, strong employment growth, further fiscal consolidation and further integration of trade and financial markets. But it will also highlight remaining challenges, in particular the need to raise growth and productivity and to ensure a better adjustment to economic shocks against the backdrop of globalisation, demographic change, climate change and strains in commodity markets.

July 2008

The Commission will publish the Seventh progress report on 'practical preparations for the future enlargement of the euro area'. Many of the newer Member States have still to adopt the euro and join the euro area. As well as the economic convergence criteria, many practical preparations need to be made for eventual euro adoption. These include legal matters, communications campaigns, preparations by banks and businesses, and many others. To ensure the adoption process goes smoothly, DG ECFIN regularly assesses the preparedness of candidate Member States to adopt the euro on a practical level.

July 2008

After the European Council discusses the issue in June, the ECOFIN Council will announce its decision on 8 July on the entry of Slovakia into the euro area. Based on a positive assessment by DG ECFIN (see article in this issue) the European Commission has found that Slovakia fulfils the convergence criteria and has recommended that it be accepted into the euro area in January 2009.

July 2008

DG ECFIN will publish the Annual Review on Labour Market Developments. This consists mainly of analysis of developments on the supply side (employment, participation, etc.) and on the cost side (wage trends, unit costs, etc). It then links these developments to macroeconomic indicators such as GDP and productivity growth within the framework of the Lisbon Strategy for Growth and Jobs.

September 2008

DG ECFIN, on behalf of the Commission, will publish its interim economic forecasts. These smaller-scale forecasts appear between the main spring and autumn forecasts. They are based on aggregated economic data from the larger Member States and give one-year projections for growth and inflation for the EU and the euro area.

Editorial information

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Recent research and analysis by DG ECFIN

European Economy Research Letter

The Directorate-General for Economic and Financial Affairs publishes a regular web-based newsletter on the research activities of its staff – the European Economy Research Letter. The next edition, due to appear in the first half of the summer, will look at some of the issues addressed in the Commission's EMU@10 report, including a broad assessment of the first ten years, current and future goals and challenges, and policies and governance of the euro area. The European Economy Research Letter is available free of charge by e-mail subscription on the DG ECFIN website: **http://ec.europa.eu/economy_finance/publications/researchletter_en.htm**

EMU@10

To mark the tenth anniversary of the EMU and the euro, DG ECFIN has created a dedicated website with resources for both economists and the general public. The Commission's major ten-year stocktaking report on EMU@10 can be found there. It also contains a collection of graphs – some interactive, all downloadable – presenting data from EMU's first decade, and a link to a series of academic papers prepared by economists from across Europe (see below). An easy reading section presents the history and benefits of Economic and Monetary Union in an accessible and interactive way for non-specialists. Visit the website at **http://ec.europa.eu/economy_finance/emu10/index_en.htm**

Economic and Monetary Union €10 ten years on

To mark the tenth anniversary of the launch of Economic and Monetary Union, DG ECFIN economists and external academic contributors are producing research publications on aspects of the first decade of EMU and the euro. These publications are part of an EMU@10 umbrella project embracing a wide range of research activities. The publications can be downloaded via a dedicated website hosted by DG ECFIN which provides information and resources on EMU for economists and non-specialists.

Some titles from the EMU@10 series are…

The international role of the euro: a status report

By Elias Papaioannou (Dartmouth College) and Richard Portes (London Business School and CEPR). European Economy, Economic Papers, 317, April 2008, ISBN 978-92-79-08242-9

The authors survey the evidence for the international role of the euro a decade on. In the early nineties, sceptical voices worried that the introduction of the euro would lead to political disintegration and economic divergence. Others argued that the euro would become a major international currency in a very short time. The authors find a 'middle-euro' scenario as the international importance of the euro grows incrementally.

Study on the impact of the euro on trade and Foreign Direct Investment

By Richard Baldwin (Graduate Institute Geneva), Virginia DiNino (Bank of Italy), Lionel Fontagné Paris School of Economics and Université Paris I, Roberto A. De Santis and Daria Taglioni (ECB). EUROPEAN ECONOMY, ECONOMIC PAPERS, 321, May 2008, Brussels, ISBN: 978-92-79-08246-7

The introduction of the euro was the world's largest economic 'experiment.' This experiment opens the door to a major advance in our understanding of how a common currency affects economic activity. Using the latest data and best empirical methodology, the authors confirm the received wisdom that the euro has promoted trade significantly and refine our understanding of exact how it does so.

The impact of the euro on international stability and volatility

By Stefan Gerlach (University of Frankfurt and CEPR) and Mathias Hoffman (Institute for Empirical Research in Economics, University of Zurich). European Economy, Economic Papers, 309, March 2008, ISBN 978-92-79-0823-4

Investigating the impact of EMU on macroeconomic volatility, the authors find that interest rates, inflation and consumption growth are all less volatile under EMU. Because global volatility has fallen outside of EMU, the authors then make bilateral comparisons to isolate the EMU contribution. Finding that pairs of EMU countries have seen greater falls in volatility than pairs in which only one member is in EMU shows that it has made a difference.

… the complete listing can be found at: http://ec.europa.eu/economy_finance/focuson/focuson12123_en.htm

All research publications can be downloaded free of charge from the DG ECFIN website: **http://ec.europa.eu/economy_finance/publications_en.htm**

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