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PACIFIC ECONOMIC COOPERATION COUNCIL

14TH GENERAL MEETING

HONG KONG – FRIDAY 30 NOVEMBER 2001

Address by Mr Michel ROCARD

My presence here is a clear message reflecting France's commitment to accompany New Caledonia, Wallis and Futuna, and Polynesia, on the path to self-government, particularly regarding their international relations. I am both honoured and somehow impressed to meet, today, with representatives of major economies and communities which account for some 50 per cent of the world production.

But your main interest, I presume, may not be limited to the foreign trade of the French Pacific Territories, however fascinating that specific issue might be.

You can easily understand how surprised I was upon receiving from some of you a message which reads as follows :

"Europe, for us Asians and inhabitants of the Pacific shores, is a chaotic mixture of very ancient countries whose future lies behind them, with a population likely to decline in the near future, and whose know-how has been mainly used to fuel devastating wars. How did you, Europeans, manage to overcome that past so as to establish a lasting peace among yourselves. How could you be so efficient in creating an integrated economy which lead to the Single Market, and give birth to a new currency : the Euro which can be seen as a potential rival for the US dollar. How will all this work out in the years to come ?"

With the permission of the PECC Member Committees, and my thanks to the Chair, Dr William K. Fung, I shall try to address these issues, because the current step towards a more integrated Europe is likely to have a direct and strong impact on Asian countries.

This is of course a long story, over half a century old. Telling it in full would take several hours. I shall try, however, to stick to the essentials.

In the early 1950's, the main idea shared at least by the six founding countries was that the world to come would be a world of giants, that our nations were too small to compete efficiently on their own in a world where a continental dimension would increasingly be the key to success. Some leaders were of the opinion that the first condition was to make it physically and institutionally impossible for European countries to initiate conflict among themselves. In this respect, it is widely agreed that international cooperation cannot solve merely local problems such as trade disputes, immigration, regional development of neighbouring countries, etc. We Europeans embarked on that process with a clear idea that it should finally result in an integrated federation. Things are less obvious.

Then arised the problem of the method to be followed. The unity of Europe is a very old idea, reflecting nostalgia for the Empire of Carolus Magnus in the ninth century. Its most eloquent spokesman was probably Victor Hugo in 1851. Nevertheless, the European Community's founding fathers, the German Konrad Adenauer, the Italian Alcide de Gasperi, the Belgian Paul Henri Spaak, the Dutchman Sicco Mansholt, and the Frenchmen Robert Schuman and Jean Monnet soon agreed that asking any national parliament to lower its flag and transfer its sovereignty in terms of security, foreign affairs and defence to some faceless, shadowy supranational body, would be a losing battle.

Instead the principle has been to create a network of technical interdependence among the countries concerned. The areas were selected with a view to prevent any transfer of sovereignty, while still being important enough to require some regulating authority.

That is why we began with strategic alliances in the coal and steel industries of the six countries, as a deterrent to war. We then tried to establish a unified military command, but we failed. The next idea was to produce our nuclear-generated electricity on a common basis.

But that was still not enough. In 1956-1957, some officials came up with the idea of a customs union. Even Jean Monnet thought this lacked prestige, and hesitated a great deal, but he finally agreed. The Treaty was drafted in six weeks by a college of some sixty persons, half of them politicians and half of them civil servants and experts. They were invited to stay on a Mediterranean resort island until the project was completed. We dare not draft treaties in that way any more, though it's probably a pity. There, too, is a suggestion for some of you !

This idea was pure genius. As a political symbol, no Parliament could object to the extension of free trade. Political reluctance arises over issues for which people are prepared to expose their lives, such as the fatherland, the flag, the king, religion, freedom, or even the national language. Who would risk his life for the sake of customs? The subject was moreover so tricky and combersome that not many journalists would be tempted to tackle its entire complexity. The negotiations went smoothly.

That is how and why six European countries decided on 1 April 1959 to remove tariffs and non-tariff barriers and replace them with a common customs tariff in their dealings with third countries. No one had ever invented a more powerful growth incentive. Over the next twenty years, the external trade of these countries grew twice as fast as world trade, especially among themselves. This produced a very large area of peace, consolidation and prosperity on the Continent. This huge success has had three major consequences. Geopolitically, Europe caught up with the

American per capita income, or let us say the American standard of living, sometime in the seventies. Internally, the mechanism more or less obliged all member countries gradually to harmonise their rules of competition, including rules for tenders, health and security standards, antitrust rules and the control of monopolies, public service management and price policies, etc. Last year, we finally adopted the Statute for the European company, to avoid distortions in competition stemming from differences in national trade laws. The same impetus is leading us, slowly but surely, to harmonise cautiously our taxation systems and increasingly the costs of our social protection systems, which vary a lot.

Finally, this success led nine new nations to join the movement in varying stages. None of them did so for the reasons that had prompted the six founders to go to work. Britain so much feared the emergence of a united political authority on the Continent that it tried for a long time to prevent this happening, creating for example an unlikely rival free trade area composed of itself, Iceland, Ireland, Norway, Sweden, Austria and Switzerland. But this fell through, and Britain became convinced from 1972 onwards that the only way to stop a political authority from emerging on the Continent was to oppose it from inside rather than outside. Her Majesty's government thus decided to join the European Community, together with Denmark and Ireland. Then came Greece, which had every reason not to expose its economy to fierce competition from Germany or France, and had even greater reason to seek democratic credentials following the end of its military regime in order to consolidate its fragile democracy. Six years later, Spain and Portugal, having got rid of their respective dictators, joined for similar reasons, namely to be labelled as democratic countries and to consolidate democracy at home. Initially, they had to fall in step, putting their economies seriously at risk; but it can be seen now that they benefited greatly from the economic impulse generated by the Common Market and from the Cohesion Fund, an important contribution by all member States to remedy the lack of infrastructures in the less developed parts of Europe. Ireland was the main beneficiary of this programme. And in the end, after the fall of the Berlin wall and the implosion of the Communist empire, the new diplomatic situation gave three neutral countries – Austria, Finland and Sweden – the opportunity to join the European Union, thereby strengthening their economies.

But the fifteen governments, whose Heads meet twice a year, have always rejected the idea that any item of foreign policy could be studied and proposed by the European Commission. Our limited foreign policy "Joint Actions" have to be decided upon unanimously by governments. They are therefore very restricted in scope and inadequate to help frame a common foreign policy. Yet, with the passing of time, this approach to foreign policy is gaining ground.

This is where we stand at present. The grand geopolitical idea of giving European countries a powerful common tool to reassert their influence over world affairs has not produced results for the time being, but this may and probably will change in the future. On the other hand, it has given birth to a vast unified market which makes Europe the most powerful economic area in the world.

To bring things up to date, I shall now comment on the financial aspect, the creation of the euro, which is the major achievement of the whole process.

The founding treaty, signed in Rome in 1957, explicitly provides for a large market to be progressively established by abolishing all internal barriers, introducing a very strict set of rules to preserve competition, prohibiting member States from using public services in a way which would distort competition, the gradual opening up of public tenders to all companies in the common market. Less clearly, reference is made to the harmonisation of tax policies, social protection and budget and monetary policies. The strength of the treaty derives largely from the fact that it created a robust set of institutions capable of enforcing all these objectives, but no others. Foreign Policy, defence, judicial policy, large areas of social policy, and education remain exclusively national prerogatives. Proposals for new decisions concerning economic and financial issues - which hence fall within the scope of the Treaty - are made and implemented by the European Commission, an embryonic government with no decision-making power. The Council of Ministers takes the decisions, either as an executive or as a legislative body, depending on what issues are being addressed. A parliamentary assembly (the European Parliament) was created. It is a consultative body whose members were originally nominated by the national parliaments of the Six but have been directly elected since 1979. The European Parliament now participates in the legislative process through the Co-Operation Procedure and the Co-Decision Procedure. It also has powers of censure, notably over the European Commission. Everything works as though the Union were a two-chamber parliamentary democracy, the Council of Ministers being one and the Parliament the other. Disputes are settled by a Court of Justice.

During the early decades, introducing open and genuine competition between those countries which had adopted more or less protectionist policies for centuries was a difficult and lengthy process. During this period, successive currency crises resulted in devaluation of most currencies, for example, the Italian lira, the Spanish peseta, the French and Belgian francs, and even the pound before Britain joined the European Economic Community. These devaluations had devastating consequences for the stability and coherence of the market, the projections of all operators and the reliability of the whole enterprise.

For this reason, Chancellor Schmidt of Germany and President Giscard d'Estaing of France proposed, around 1974, creating a European Monetary System in order to limit the risks of such monetary upheavals. It worked quite well, though most governments responded with excessive timidity and did not, for reasons of prestige, opt for slight, though frequent, readjustments of their exchange rates. The system thus collapsed in 1992, at which point the lira, the peseta and the pound were obliged to leave it. But experts and politicians were aware of the system's fragility long before then. The main fear, for all of us, was that a huge currency crisis might force a number of member States to withdraw from the Common Market itself, in which case half a century of political efforts would be annihilated. The idea of a single currency first surfaced in the eighties. Mrs Thatcher and Mr Major expressed outright indignation at this ghastly prospect.

The other member States examined the idea more objectively and serenely. It was adopted as a collective commitment in a Treaty signed in the small Dutch town of Maastricht in 1992, with Britain and Denmark and in fact any other country having the right to opt out if they wished.

That's where difficulties began. Some of the member States which wanted to participate in the single currency were in a poor financial situation. France had gone through nineteen devaluations since 1945, but had achieved monetary stability ten years earlier. Price stability was recent in France, but it rested on solid foundations. The same could not be said of Italy and Spain, and the Belgian public debt equalled its gross national product.

The method, here again essential, was to define five yardsticks, which were price increases, government deficit, public debt, exchange rates, and long-term interest rates, and to measure every year the degree to which each applicant country was meeting them. In 1998, the European Commission was to produce a report to assess which member States were in a position to join the single currency and which were not. This was a horribly difficult exercise. At that early stage, most English and American experts or politicians, confusing their hopes with their forecasts, wrote that the operation would not work. During the next stage of the process, when the Spaniards and Italians began making their astounding effort, some German bankers expressed doubts about the capacity of southern European countries to join. A period of furore and turmoil followed. Three new countries joined the Union. Although the economies of all three countries were well-managed, this did not simplify matters.

But when the European Commission published its report, it turned out, to everyone's surprise, that all countries but one had fulfilled the financial requirements for joining. Greece, the only country to fail, succeeded in meeting the targets two years later and has now joined the eurozone. Of the fourteen who could have joined, three refused to do so, namely Sweden, Denmark and Britain. Public opinion, like the press, remains clearly Europhobic in the UK, despite the clearly favourable stance adopted by the Confederation of British Industry and the Trades Union Congress.

Anyway, we joined. Since the first of January 1999, the 11 and now 12 members of the eurozone have been using the euro for all international transactions. Our twelve currencies have strictly fixed parities against one another and against the nominal euro. In fact, for nearly three years now they have been national sub-units of the common single currency. In just a month from now they will disappear, and the banknotes and coins of the twelve countries will be replaced by euro banknotes and coins. It is an immensely complicated operation. Some ten billion banknotes and forty billion coins are being printed or minted and transported, shielded from the fascination of criminals, while 340 million consumers are wondering how they will manage switchover calculations.

Never in history was such a vast economic entity born peacefully, by mutual agreement. Will it work? How can the euro today be assessed in terms of results and prospects?

Within the eurozone, the technical management of converting all cross-border operations and transactions to the euro has been a success unmarred by breakdowns, drama or delays. Exchange risk premiums between our twelve currencies disappeared at once and transaction costs began to diminish significantly, descending to zero in a few months. This has contributed to an increase in our collective gross product of almost 0.5 per cent.

On the international stage, the euro is a major currency in world trade. Euroland accounts for 15 per cent of world exports. Roughly speaking, between two-thirds and three-quarters of the euro area's external trade is denominated in euros. The euro also acts as a magnet for the countries which have close trade links with the euro area. In Great Britain, for instance, nearly 30 per cent of international trade transactions are already being carried out in euros. Major British exporters, especially the subsidiaries of international groups, increasingly ask their counterparts to bill them in euros.

On the commodity market, there are signs that important commodity exporters could begin diversifying their currency exposure by partly billing their exports in euros.

The euro has already gained a leading position on the bond market.

I should like to make a specific point about the euro-bond market, since sovereign bond-issuers, especially France and Germany which are among the market's biggest borrowers, are particularly sensitive to the development of an integrated and efficient debt market. Investors will benefit from the ongoing efforts by euro sovereign issuers to improve the transparency and predictability of their issuing policies. This is a fitting answer to the concern sometimes expressed, especially by Japanese investors, about the coexistence of twelve sovereign issuers issuing in a common currency. Issuers have also made great efforts to increase the liquidity of their debt.

Consequently, the Euro-government debt has become much more efficient, after only two years of euro-denominated issuing policies. The size of the Euro-government debt, its liquidity and its sophistication are comparable to those of the US Treasury market.

The rapid emergence of an efficient government debt market denominated in euros is contributing to the swift development of a corporate bond market. Since the introduction of the single currency, corporate issuance totalled more than 230 billion euros, an amount roughly comparable to the issuance volume in dollars. The euro-denominated bond market is a high-grade one (95 per cent of the total amount issued is A-rated or better). On the supply side also, it is one of the most diversified, as well as being one of the most internationalised – in the corporate sector alone, euro area-resident issuers account for only slightly more than half.

I see two merits in this very fast and positive evolution. It is good for European companies, which can expand their financing tools and find better financing conditions, and it is beneficial for investors, who can discover a wider range of opportunities.

The emergence of a major currency offers real diversification opportunities for official reserve managers. 66 per cent of official reserves are still denominated in dollars. The euro represents an important diversification opportunity. Euro-denominated reserves already account for 12.5 per cent of world official reserves and this "market share" has considerable potential for expansion. It should be remembered that it is the currency of more than 300 million people with high purchasing power, and that the changeover on 1 January 2002 to a "real" currency in the pockets of these 300 million people will be a powerful asset and incentive.

The unforeseen development, which weakened external confidence in the euro, was the decline in exchange rates. What happened?

We all, probably like you, had our eyes fixed on the deutsche mark, a strong currency, absolutely reliable, and the most influential in Europe. In signing the Treaty, we not only adopted the principle of a common single currency called the euro, but we adopted along with it the German monetary philosophy of a strong currency, total Central Bank independence, and absolute priority given to the struggle against inflation whatever the price in terms of growth or employment. And we all believed that the majesty of the construction, the scale of the adventure would induce observers, operators and investors to share these optimistic views and establish the euro somewhere around 1.10 US dollar, when it saw the light of day in January 1999.

There had already been an encouraging first sign. When the Asian financial crisis exploded in 1996-1997, the fearful anticipation of financial operators affected many currencies, especially those of the emerging economies and the Central European countries. In Western Europe, the turmoil hurt the British pound and the Swedish krona, but none of the currencies destined to join the eurozone. The euro is associated with security, and this is good news for the future.

But things changed strikingly soon after, for a number of reasons, mostly unforeseen, and with cumulative effect. The first was that Germany began to experience a growth slowdown. The second was that over the same period, growth in the United States accelerated. The third was that investors and operators looking for safe places for their liquidities could not limit their investigations to price movements, trade balances, and the size of public and private debt, in which case they would have chosen the euro, but were obliged to include world strategy and military power considerations, and so banked on the US dollar. The fourth reason was the amazingly strong performance of the "E" or "new" economy in the USA.

Between 1980 and 1995, capital movements between Europe and the USA had been roughly balanced, comparable in size in both directions. But between 1996 and 2000 they were five times greater in volume from Europe to the United States than the other way round. This had an obvious effect on parity.

But, given the size and economic power of the eurozone, these reasons do not seem to me sufficient. Strangely enough, there is no officially accepted explanation of what has happened.

I shall give you mine, with which not everyone agrees. I am probably not enough of an academic.

A currency, despite its important legal functions, is a market product. It is expensive when it is rare and cheap when abundant, when the offer exceeds the demand. The market balance depends on the policy mix which is followed.

Throughout the decade during which the euro was being prepared, the main worry of our twelve Central Bank Governors and the highly influential German authorities was inflation and public deficits. For this reason, we West Europeans saddled ourselves with six years of extremely severe budgetary constraints, with strong limitations not only on deficits, but even on spending. The economic impact of public finances on growth became negligible, if not nil or negative. Growth slowed down significantly. To offset that, monetary policy was liberal so as to allow the financing of investment. But investment demand also slowed down, owing to poor growth prospects. So we had a large supply of money and very little demand for it. The effect was mechanical and irresistible, and the euro, which was hoped to be set at 1.10 US dollars by 1998, dropped quickly and sharply to nearly 80 cents. It seems to have levelled out in the last few weeks at around 90 cents.

There is in my view no mystery here, except the macroeconomists' collective error of prognosis. In any event, such a policy mix was necessary for the introduction of the single currency. The cost has been a loss of confidence among outside investors. But there have been significant gains as well. The first has been a very powerful boost to our exports, which in return has facilitated acceptance of the euro. The second is that it has restrained us from dangerous political controversy on the virtues and vices of a strong currency in situations of high under-employment. The policy brew has now changed in Europe, the new economy investment stampede is over, growth is stronger in Europe than in the United States, and our basics – trade balance, level of debt and price increases – are all sounder than the American ones. The reasonable prognosis is appreciation of the euro in the mid-term.

A last point must be underlined.

Our motivations in creating the euro were purely internal. The aim was to make the Common Market truly irreversible, and put an end to our traditional propensity for disputes, conflicts and wars. The idea of competing with the dollar or indulging in some sort of rivalry was not at all on the agenda, even if the consequences in these respects cannot be overlooked.

So there we have it, ladies and gentlemen. Europe is now a powerful economic and financial unit, more and more coherent, more and more capable of playing a united game in world economic affairs.

Diplomatic and military affairs remain national preserves. But this appears more and more illogical, not to say ridiculous. No one was able to understand our paralysis in the face of the Balkans crisis, or even in the Middle East. In fact, there are enormous pressures at work – proximity, evident community of interests, the logic of an ever more unified financial diplomacy. Already now the foreign action of the European Union, even if it began too late, is unified in Kosovo and Macedonia and it is becoming so in the Middle East. Europe is furthermore building, on the basis of a unanimous decision, an integrated military force of 60 000 men capable of being sent anywhere, and staying a year, mostly for United Nations assignments. Within ten years, we shall have a European diplomacy to present to the world.

Our legal policies, on the other hand, are becoming increasingly integrated into the Union's processes. Europe is no more an exclusively economic entity.

That is part of the reason why thirteen new countries have applied to join. They are the three Baltic states, Latvia, Lithuania and Estonia, along with Poland, Hungary, the Czech Republic, Slovakia, Romania, Bulgaria, Slovenia, Cyprus, Malta and Turkey. The process will take from three to twenty years. No one knows what Europe will look like afterwards. But we have already surmounted more difficult obstacles. It should now be clear to anyone that Europe nowadays offers a fantastic opportunity for investment.

You have watched the ups and downs of European construction over the years. It's part of history now. I don't intend actually to tell you that "you should do the same". Things are different in the Asia-Pacific area, times are different, culture is different and we must respect everyone's specific character and pace of change.

But my message to Asia-Pacific might be this: Why not build upon the "open regionalism" which is the goal of APEC and PECC? This already provides a direction, and an incentive to develop regional integration in a constructive spirit, region by region, taking into account constraints and disparities. Regionalism is not inconsistent with globalisation and liberalisation. It can even be regarded as a stepping-stone. From what I have just told you you can see that regionalism is probably the best way for opening up economies to the world.

If you don't mind, I shall take the symbolic example of the Pacific Island Countries to illustrate my point. They unanimously decided at the last Pacific Forum to set up in ten years a Free Trade Zone among themselves, no matter how vulnerable and fragile they may be. It's a real challenge. We support this move and encourage New Caledonia and French Polynesia – which are fully in charge of their trade – to harmonise their policies and join the movement as soon as they can.

There is no reason for limiting this example to small countries. After all, Europe set its own process in motion largely because it thought it was still great.

As to the objective of a common currency, I shall express even more caution. It took fifty years for Europe to achieve this goal. It is a long and demanding process. In the present economic and financial situation of the Asia-Pacific region following the

1997 crisis, my advice would be to seek closer coordination between financial institutions and central banks. This working together is a necessary step towards any more ambitious objective, including, at the right moment, the setting up of a common currency.

The path is long. But what Europe knows best about Asia is that you are patient. Good luck. My presence here is a clear message reflecting France's commitment to accompany New Caledonia, Wallis and Futuna, and Polynesia, on the path to self-government, particularly regarding their international relations. I am both honoured and somehow impressed to meet, today, with representatives of major economies and communities which account for some 50 per cent of the world production.

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The other member States examined the idea more objectively and serenely. It was adopted as a collective commitment in a Treaty signed in the small Dutch town of Maastricht in 1992, with Britain and Denmark and in fact any other country having the right to opt out if they wished.

That's where difficulties began. Some of the member States which wanted to participate in the single currency were in a poor financial situation. France had gone through nineteen devaluations since 1945, but had achieved monetary stability ten years earlier. Price stability was recent in France, but it rested on solid foundations. The same could not be said of Italy and Spain, and the Belgian public debt equalled its gross national product.

The method, here again essential, was to define five yardsticks, which were price increases, government deficit, public debt, exchange rates, and long-term interest rates, and to measure every year the degree to which each applicant country was meeting them. In 1998, the European Commission was to produce a report to assess which member States were in a position to join the single currency and which were not. This was a horribly difficult exercise. At that early stage, most English and American experts or politicians, confusing their hopes with their forecasts, wrote that the operation would not work. During the next stage of the process, when the Spaniards and Italians began making their astounding effort, some German bankers expressed doubts about the capacity of southern European countries to join. A period of furore and turmoil followed. Three new countries joined the Union. Although the economies of all three countries were well-managed, this did not simplify matters.

But when the European Commission published its report, it turned out, to everyone's surprise, that all countries but one had fulfilled the financial requirements for joining. Greece, the only country to fail, succeeded in meeting the targets two years later and has now joined the eurozone. Of the fourteen who could have joined, three refused to do so, namely Sweden, Denmark and Britain. Public opinion, like the press, remains clearly Europhobic in the UK, despite the clearly favourable stance adopted by the Confederation of British Industry and the Trades Union Congress.

Anyway, we joined. Since the first of January 1999, the 11 and now 12 members of the eurozone have been using the euro for all international transactions. Our twelve currencies have strictly fixed parities against one another and against the nominal euro. In fact, for nearly three years now they have been national sub-units of the common single currency. In just a month from now they will disappear, and the banknotes and coins of the twelve countries will be replaced by euro banknotes and coins. It is an immensely complicated operation. Some ten billion banknotes and forty billion coins are being printed or minted and transported, shielded from the fascination of criminals, while 340 million consumers are wondering how they will manage switchover calculations.

Never in history was such a vast economic entity born peacefully, by mutual agreement. Will it work? How can the euro today be assessed in terms of results and prospects?

Within the eurozone, the technical management of converting all cross-border operations and transactions to the euro has been a success unmarred by breakdowns, drama or delays. Exchange risk premiums between our twelve currencies disappeared at once and transaction costs began to diminish significantly, descending to zero in a few months. This has contributed to an increase in our collective gross product of almost 0.5 per cent.

On the international stage, the euro is a major currency in world trade. Euroland accounts for 15 per cent of world exports. Roughly speaking, between two-thirds and three-quarters of the euro area's external trade is denominated in euros. The euro also acts as a magnet for the countries which have close trade links with the euro area. In Great Britain, for instance, nearly 30 per cent of international trade transactions are already being carried out in euros. Major British exporters, especially the subsidiaries of international groups, increasingly ask their counterparts to bill them in euros.

On the commodity market, there are signs that important commodity exporters could begin diversifying their currency exposure by partly billing their exports in euros.

The euro has already gained a leading position on the bond market.

I should like to make a specific point about the euro-bond market, since sovereign bond-issuers, especially France and Germany which are among the market's biggest borrowers, are particularly sensitive to the development of an integrated and efficient debt market. Investors will benefit from the ongoing efforts by euro sovereign issuers to improve the transparency and predictability of their issuing policies. This is a fitting answer to the concern sometimes expressed, especially by Japanese investors, about the coexistence of twelve sovereign issuers issuing in a common currency. Issuers have also made great efforts to increase the liquidity of their debt.

Consequently, the Euro-government debt has become much more efficient, after only two years of euro-denominated issuing policies. The size of the Euro-government debt, its liquidity and its sophistication are comparable to those of the US Treasury market.

The rapid emergence of an efficient government debt market denominated in euros is contributing to the swift development of a corporate bond market. Since the introduction of the single currency, corporate issuance totalled more than 230 billion euros, an amount roughly comparable to the issuance volume in dollars. The euro-denominated bond market is a high-grade one (95 per cent of the total amount issued is A-rated or better). On the supply side also, it is one of the most diversified, as well as being one of the most internationalised – in the corporate sector alone, euro area-resident issuers account for only slightly more than half.

I see two merits in this very fast and positive evolution. It is good for European companies, which can expand their financing tools and find better financing conditions, and it is beneficial for investors, who can discover a wider range of opportunities.

The emergence of a major currency offers real diversification opportunities for official reserve managers. 66 per cent of official reserves are still denominated in dollars. The euro represents an important diversification opportunity. Euro-denominated reserves already account for 12.5 per cent of world official reserves and this "market share" has considerable potential for expansion. It should be remembered that it is the currency of more than 300 million people with high purchasing power, and that the changeover on 1 January 2002 to a "real" currency in the pockets of these 300 million people will be a powerful asset and incentive.

The unforeseen development, which weakened external confidence in the euro, was the decline in exchange rates. What happened?

We all, probably like you, had our eyes fixed on the deutsche mark, a strong currency, absolutely reliable, and the most influential in Europe. In signing the Treaty, we not only adopted the principle of a common single currency called the euro, but we adopted along with it the German monetary philosophy of a strong currency, total Central Bank independence, and absolute priority given to the struggle against inflation whatever the price in terms of growth or employment. And we all believed that the majesty of the construction, the scale of the adventure would induce observers, operators and investors to share these optimistic views and establish the euro somewhere around 1.10 US dollar, when it saw the light of day in January 1999.

There had already been an encouraging first sign. When the Asian financial crisis exploded in 1996-1997, the fearful anticipation of financial operators affected many currencies, especially those of the emerging economies and the Central European countries. In Western Europe, the turmoil hurt the British pound and the Swedish krona, but none of the currencies destined to join the eurozone. The euro is associated with security, and this is good news for the future.

But things changed strikingly soon after, for a number of reasons, mostly unforeseen, and with cumulative effect. The first was that Germany began to experience a growth slowdown. The second was that over the same period, growth in the United States accelerated. The third was that investors and operators looking for safe places for their liquidities could not limit their investigations to price movements, trade balances, and the size of public and private debt, in which case they would have chosen the euro, but were obliged to include world strategy and military power considerations, and so banked on the US dollar. The fourth reason was the amazingly strong performance of the "E" or "new" economy in the USA.

Between 1980 and 1995, capital movements between Europe and the USA had been roughly balanced, comparable in size in both directions. But between 1996 and 2000 they were five times greater in volume from Europe to the United States than the other way round. This had an obvious effect on parity.

But, given the size and economic power of the eurozone, these reasons do not seem to me sufficient. Strangely enough, there is no officially accepted explanation of what has happened.

I shall give you mine, with which not everyone agrees. I am probably not enough of an academic.

A currency, despite its important legal functions, is a market product. It is expensive when it is rare and cheap when abundant, when the offer exceeds the demand. The market balance depends on the policy mix which is followed.

Throughout the decade during which the euro was being prepared, the main worry of our twelve Central Bank Governors and the highly influential German authorities was inflation and public deficits. For this reason, we West Europeans saddled ourselves with six years of extremely severe budgetary constraints, with strong limitations not only on deficits, but even on spending. The economic impact of public finances on growth became negligible, if not nil or negative. Growth slowed down significantly. To offset that, monetary policy was liberal so as to allow the financing of investment. But investment demand also slowed down, owing to poor growth prospects. So we had a large supply of money and very little demand for it. The effect was mechanical and irresistible, and the euro, which was hoped to be set at 1.10 US dollars by 1998, dropped quickly and sharply to nearly 80 cents. It seems to have levelled out in the last few weeks at around 90 cents.

There is in my view no mystery here, except the macroeconomists' collective error of prognosis. In any event, such a policy mix was necessary for the introduction of the single currency. The cost has been a loss of confidence among outside investors. But there have been significant gains as well. The first has been a very powerful boost to our exports, which in return has facilitated acceptance of the euro. The second is that it has restrained us from dangerous political controversy on the virtues and vices of a strong currency in situations of high under-employment. The policy brew has now changed in Europe, the new economy investment stampede is over, growth is stronger in Europe than in the United States, and our basics – trade balance, level of debt and price increases – are all sounder than the American ones. The reasonable prognosis is appreciation of the euro in the mid-term.

A last point must be underlined.

Our motivations in creating the euro were purely internal. The aim was to make the Common Market truly irreversible, and put an end to our traditional propensity for disputes, conflicts and wars. The idea of competing with the dollar or indulging in some sort of rivalry was not at all on the agenda, even if the consequences in these respects cannot be overlooked.

So there we have it, ladies and gentlemen. Europe is now a powerful economic and financial unit, more and more coherent, more and more capable of playing a united game in world economic affairs.

Diplomatic and military affairs remain national preserves. But this appears more and more illogical, not to say ridiculous. No one was able to understand our paralysis in the face of the Balkans crisis, or even in the Middle East. In fact, there are enormous pressures at work – proximity, evident community of interests, the logic of an ever more unified financial diplomacy. Already now the foreign action of the European Union, even if it began too late, is unified in Kosovo and Macedonia and it is becoming so in the Middle East. Europe is furthermore building, on the basis of a unanimous decision, an integrated military force of 60 000 men capable of being sent anywhere, and staying a year, mostly for United Nations assignments. Within ten years, we shall have a European diplomacy to present to the world.

Our legal policies, on the other hand, are becoming increasingly integrated into the Union's processes. Europe is no more an exclusively economic entity.

That is part of the reason why thirteen new countries have applied to join. They are the three Baltic states, Latvia, Lithuania and Estonia, along with Poland, Hungary, the Czech Republic, Slovakia, Romania, Bulgaria, Slovenia, Cyprus, Malta and Turkey. The process will take from three to twenty years. No one knows what Europe will look like afterwards. But we have already surmounted more difficult obstacles. It should now be clear to anyone that Europe nowadays offers a fantastic opportunity for investment.

You have watched the ups and downs of European construction over the years. It's part of history now. I don't intend actually to tell you that "you should do the same". Things are different in the Asia-Pacific area, times are different, culture is different and we must respect everyone's specific character and pace of change.

But my message to Asia-Pacific might be this: Why not build upon the "open regionalism" which is the goal of APEC and PECC? This already provides a direction, and an incentive to develop regional integration in a constructive spirit, region by region, taking into account constraints and disparities. Regionalism is not inconsistent with globalisation and liberalisation. It can even be regarded as a stepping-stone. From what I have just told you you can see that regionalism is probably the best way for opening up economies to the world.

If you don't mind, I shall take the symbolic example of the Pacific Island Countries to illustrate my point. They unanimously decided at the last Pacific Forum to set up in ten years a Free Trade Zone among themselves, no matter how vulnerable and fragile they may be. It's a real challenge. We support this move and encourage New Caledonia and French Polynesia – which are fully in charge of their trade – to harmonise their policies and join the movement as soon as they can.

There is no reason for limiting this example to small countries. After all, Europe set its own process in motion largely because it thought it was still great.

As to the objective of a common currency, I shall express even more caution. It took fifty years for Europe to achieve this goal. It is a long and demanding process. In the present economic and financial situation of the Asia-Pacific region following the 1997 crisis, my advice would be to seek closer coordination between financial institutions and central banks. This working together is a necessary step towards any more ambitious objective, including, at the right moment, the setting up of a common currency.

The path is long. But what Europe knows best about Asia is that you are patient. Good luck.