Introduction: Welcome remarks from the 2001 conference

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Twelve years after the fall of the iron curtain we still see remarkable differences in real GDP per capita between the accession countries and the member states of the European Union. After the strong recession at the beginning of the 1990s most accession countries managed to generate real growth rates of GDP that lie well above the EU average. At the same time unemployment rates rose to relatively high levels – a consequence of the restructuring process from a planned to a market economy. Here the question might be asked whether the wealth gap is diminishing, and what are the driving forces behind what can be called a 'convergence process'.

This volume aims at shedding a light on the problem of economic convergence between regions and countries with different, often vastly different, income-per-capita levels. It will focus on the theoretical fundamentals, on historical evidence and on challenges for economic policy, offering a forum for discussion on the current 'best policies' to foster convergence.

CONVERGENCE THEORY

The neoclassical model of economic growth is the standard starting point among the theoretical approaches to explaining economic convergence. The neoclassical model postulates that countries which are identical in terms of demographic development, saving habits and production technologies but differ in terms of their initial factor endowments display a growth differential and reach the same level of output after convergence in factor inputs has been achieved. Hence the model predicts real convergence, meaning the 'catching up' of emerging economies' output and thus income-per-capita levels to those of their richer neighbours. The driving force behind convergence is the relatively higher rate of return on physical capital, which boosts capital accumulation in the less-developed countries. However, it takes a certain production technology as exogenously given.

Therefore, by excluding technological progress, the endogenous limit to growth is determined by diminishing marginal returns, which are a physical feature of the production process and as such not subject to the choice of policy-makers or private agents.

In contrast, the 'new' growth theory does not feature diminishing marginal returns, as it incorporates the production technology applied into the model as an endogeneous variable, which makes it possible to explain continuous growth of per capita output. Therefore, in this strand of growth theory, the issues of convergence boil down to the factors determining the level of production technology: first, the transfer of efficiency-enhancing methods of production, and second, the benefits of tearing down economic borders. Abolishing economic borders not only supports the transfer of know-how and technology, but also increases the size of markets and thus makes cost-intensive research and development efforts more affordable, promoting technological change.

Xavier Sala-i-Martin presents further insights on the theoretical concepts of convergence and general empirical results of growth accounting in Chapter 7.

CONVERGENCE AND DIVERGENCE WITHIN THE EUROPEAN UNION

This volume will deal with the question of convergence both from the perspective of the European Union as well as from the perspective of the accession countries in terms of their convergence towards EU levels. Let me start by looking at the EU countries, in particular the euro area countries.

Convergence and divergence issues are, indeed, topical for monetary policy-making in Europe in a number of ways. In the run-up to economic and monetary union, convergence was very much at the centre stage. More recently, issues of divergence within EMU – be it inflation differentials, diverging wage developments or external imbalances – have captured increasing attention. There is a lively discussion about whether these developments should be perceived as a source of concern. I think we should not exaggerate these recent instances of divergence, having reached so high a degree of economic convergence through a process of several decades that we opted to introduce a single currency. Moreover, other examples of monetary unions, such as the USA, show that the development of economic indicators does not need to be completely synchronized for such a monetary union to achieve economic success.

ACCESSION COUNTRIES: REAL AND NOMINAL CONVERGENCE

A distinction between 'nominal' and 'real' convergence has entered the political and economic debate about the accession process of new member states to the European Union. While real convergence is often related to the development and adjustment of economic structures or to the building of the institutional and legal framework, the most commonly used dimension of real convergence relates to the levels of economic development, meaning the catching up of poorer regions or countries to the per capita income levels of richer economies.

Nominal convergence, on the other hand, stands for the convergence of important economic indicators, such as the inflation rate, fiscal deficit ratios or interest rates, towards a benchmark. The best known benchmarks in this regard are the Maastricht criteria.

What is the interrelation between such nominal convergence and real convergence in income-per-capita levels? What economic and monetary policy design should be adequate for the accession process to the European Union?

The position of the Eurosystem (that is, of the European Central Bank and the other national central banks of the euro area) is that nominal and real convergence should be pursued in parallel, in a mutually balanced way. In my view, this is a very sensible position. We cannot separate nominal and real convergence, dropping the first target while favouring the other – or vice versa. The challenge is to pursue them in parallel, fostering structural reforms and productivity growth in a stability-oriented environment. It follows that this position does not support applying excessively restrictive policies that aim to fulfil the Maastricht criteria at any cost in the shortest possible period of time.

For European integration, structural as well as institutional and legal convergence are of the utmost importance. The Copenhagen criteria for EU membership establish a consistent and comprehensive framework that is precisely about these dimensions of convergence, although one may question whether the body of EU law, the *acquis communautaire,* in all of its facets provided for structures and institutions that are equally well suited to high-income and to middle-income countries. Note that the Copenhagen criteria do not focus on the convergence of the levels of economic development. This is perfectly in line with economic theory, which holds that the convergence of per capita income levels is not a necessary condition for a successful and mutually beneficial integration into the EU internal market. At the same time one has to bear in mind the political and social environment, and one has to take into account existing concerns about possible negative effects on local labour markets and income distribution – not least in order to ensure public support. However, I am convinced that sensible compromise solutions have already been mutually agreed (for instance, on the issue of the free movement of persons), and necessary further agreements will still be found during the accession negotiations.

Empirical evidence shows that real convergence in terms of structural institutional changes has progressed far in most of the accession countries. These developments have established the groundwork for a sound and sustainable growth process. While real growth rates have been above EU levels since the mid-1990s in most of the countries, only six of ten accession countries have managed to narrow the GDP-per-capita gap to the EU average since then. Recognizing all the positive effects of the accession process, one should not overlook the rise in unemployment in most accession countries in recent years – mainly as a consequence of the restructuring process.

In financial markets the most positive development in EU accession countries is the process of harmonizing their financial service legislation with the relevant EU directives to ensure greater transparency in capital markets and to provide for depositor protection in the banking sector. The Czech Republic, Hungary, Poland and Slovenia made progress in this regard, but – according to the analysis of the EBRD – show a certain implementation gap. The effective implementation and enforcement of capital market laws remain a problem throughout the region, possibly because there is a need to create independent capital market regulators. Efforts should focus in particular on the adequacy of the administrative and legal framework. An adequate framework remains crucial for the long-term sustainability of economic growth.

One positive effect emerging from the accession process to the EU is the lower vulnerability of accession countries' financial markets during stress periods, such as the financial crises in Turkey or Argentina. Furthermore, as a consequence of the restructuring process, the accession countries managed to reduce the share of bad loans in the banking sector drastically.

A NEW DIVIDE BETWEEN ACCESSION COUNTRIES AND OTHER EMERGING ECONOMIES?

This volume will also address the question of whether a new divide between accession countries and other emerging markets might emerge in Europe.

At the level of the regions, we are witnessing a growing polarization within the accession countries. In a number of cases, the more prosperous regions are developing very dynamically while the other parts of the countries are much less vibrant or even stagnating.

At the country level it is argued that, as accession countries converge, a new divide may emerge in Europe between an enlarged European Union on the one hand and the CIS countries and the Western Balkans on the other. However, the economic performance of Russia and Ukraine, which had been dismal for a long time, has recently been surprisingly positive. In the Western Balkans, in turn, the economic situation appears to be very diverse, with some countries showing progress in moving closer to the European Union and others experiencing difficulties in overcoming the legacies of the past.

Can Europe do anything more to link this part of the continent more closely to mainstream developments? These issues are addressed more thoroughly in Parts V and VI.

BEST POLICIES

Finally, the chapters in Part VII discuss the 'best policies' to foster economic convergence. They address both convergence within the present euro area and convergence within the future enlarged European. Due account should be taken of the responsibility the present and, later on, the enlarged European Union has to assume for deepening relations with the new Eastern neighbours which emerge in the wake of enlargement.

THE OeNB'S ROLE IN THE TRANSITION PROCESS

Before concluding, let me briefly describe how we see the role of the Oesterreichische Nationalbank in the transition process and the contribution it can make to supporting economic convergence within Europe.

I think I can best describe our involvement by sketching the OeNB's major transition-related activities:

1. We have been extending technical assistance to the central banks of Central and Eastern Europe and the CIS countries since the very beginning of transition. In the 1990s, we constantly reinforced our activities in this area, starting with basic training and technical support in the early days of transition and now focusing mainly on sophisticated assistance in very specific areas. In some cases, these activities have evolved into technical co-operation among equal partners, a trend we expect to become more pronounced in the years to come.
2. We have substantially stepped up our analytical work on the transition economies over the past years. We perceive our expertise in this area as

a service to the other Austrian authorities and the Austrian public at large but also, and equally so, to agents in the international arena, in particular to the Eurosystem.

3. We have initiated a number of activities to provide a platform and a meeting place for debating transition- and convergence-related questions and topics. Again, we target both the Austrian level and, at least on occasion, the international plane. The East–West Conference is a very concrete and high-profile case in point, but it is not the only one. In fact, we also organize several other serial events which promote regular discussions on these issues.

Apart from these general transition-related activities, we have been actively involved in the EU accession process. As a central bank, we assist in shaping the Austrian position in the EU accession negotiations in the areas of central bank competence and co-competence (primarily related to three negotiation chapters, namely 'Economic and monetary union', 'Freedom of capital movements' and 'Freedom of services', in particular financial services).

Last but not least, we are keen on fostering the dialogue between the Eurosystem and the central banks of the applicant countries.