Foreword

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The Oesterreichische Nationalbank's annual East–West Conference, on which this volume is based, is designed as an international forum in which leading experts from government and international organizations, central and commercial banks, as well as universities and research institutes deal with questions of the transition process and EU enlargement. 'Structural challenges and the search for an adequate policy mix in the EU and in Central and Eastern Europe' is the comprehensive and demanding topic at the centre of this volume. In recent years we have already witnessed momentous – I would say, historic – changes in Europe, and the momentum will be continuing, probably even accelerating, in the years to come. After the completion of the internal market and the most recent enlargement of the EU in the middle of the 1990s, which also made my home country a member of the European Union, we embarked on a bold strategy of further deepening and widening our Union.

On 1 January 1999, the euro was introduced as a single currency for more than 300 million people. At first, the euro was – so to speak – 'virtual'. At the beginning of 2002, however, the cash changeover took place and since March 2002 all euro area citizens have indeed had the same currency in their pockets. The cash changeover has been completed very successfully with the broad – and often enthusiastic – support of the European citizens. Now our eyes are boldly fixed on a new horizon: the further enlargement of the European Union. After centuries of wars and conflicts and half a century of cold war and painful division, our continent is in the process of growing together in peace – arguably for the first time in history.

In autumn 2002, the European Commission issued its latest progress report, assessing that a considerable number of countries will soon be prepared to enter the EU. Although huge efforts still have to be made and major decisions have yet to be taken, in 2004 we hope to be able to welcome ten new member countries to the European Union, and a few years later, some more. In terms of the number of new members, population and economic growth potential, this will be the most important enlargement of the EU to date.

In this perspective, the challenges facing Europe in the coming years and

decades are complex, exciting and daunting. It is these challenges, tasks, problems and prospects that we will discuss in this volume.

As a point of departure, Part I will try to describe and evaluate where Europe stands today with respect to structural reforms and competitiveness. It is known that despite recent achievements, Europe has been trailing behind the US in the last 10 to 15 years as regards economic growth, the expansion of productivity and the creation of new jobs. Many experts agree that this may be largely due to certain structural problems and rigidities in Europe compared with the US. In 2000 the so-called Lisbon process was launched to tackle existing shortcomings. Read up in Part I on what the contributors have to say on these issues.

Part II is dedicated to a sector that is pivotal for efforts to accelerate and dynamize growth in Europe, namely the financial and banking sector. Contributors focus on developments in Central and Eastern Europe, in particular on the extent to which the sector has been improving its function as a financial intermediary in recent years. But they also touch upon Western European issues and the evolution of pan-European integration tendencies in banking. Such tendencies have been exhibited by the activities of Austrian banks which are highly involved in Central and Eastern Europe and thus are contributing to the 'growing together' of our continent.

How will EU enlargement be financed and where are the resources for catching up? This will be the subject of Part III, which is largely devoted to important and difficult budgetary decisions that will have to be made in accession countries, member states and at the European level. In no case should accession countries, when they join the EU, find themselves in a worse financial situation than before joining. Also look out for an assessment of whether the most important inflow of foreign direct investment (FDI) has already run its course in Central and Eastern Europe or whether substantial further 'waves' can be expected upon accession and, at a later stage, entry into the European and Monetary Union (EMU).

In these times of accelerated change, social security reforms, in particular labour market and pension reforms play an important role. They are the topic of Part IV. The extent of unemployment in many Western and Eastern European countries gives rise to concern and calls for measures to improve the functioning of labour markets. Ageing is a phenomenon particularly strongly affecting Europe. Pension reforms appear to be a two-way learning street: current EU members may also learn from reforms launched and experiences gathered in some accession countries.

Part V deals with the nuts and bolts of fiscal systems in Europe and how they can be made more efficient. Respective developments vary among current EU members as well as among accession candidates. Budget deficits are relatively large in some countries, whereas others have managed to

reduce shortfalls. A number of countries feature levels of taxation that are relatively high in international comparison.

But it is not only the level of taxes and expenditures that would seem important; just as important are their respective structures, which should be shaped so as to increase long-term balanced growth perspectives. Are there any advantages in tax coordination as compared to tax competition?

Part VI will focus on enterprise sector reform and network industries. Since the bulk of enterprises, including large ones, have been privatized in accession countries, one can say that now the private sector holds sway across Europe. This, of course, does not mean that there are no substantial restructuring needs any more. A number of large firms remain slated for privatization in Western and in Eastern Europe, many of them belonging to utilities and network industries.

Given the nature of their markets in which they often have monopoly or quasi-monopoly positions, the takeover of these industries by private investors requires a good state regulatory framework. More generally, FDI may be regarded as a major factor of 'microeconomic unification' of Europe. On the other hand, small and medium-sized enterprises constitute the backbone of the economy of practically every European country, and legal and regulatory obstacles to their activities should be removed as far as possible.

Given the establishment of EMU, the various structural changes and the catching up processes accompanying European integration, Part VII focuses on the question of an adequate policy mix to deal with upcoming challenges. Can integration-related additional expenditure needs, for example on infrastructural investments, be reconciled with necessary fiscal prudence? How is the Stability and Growth Pact assessed today? What is the adequate macroeconomic and macro-structural policy mix for catching up?

In Part VIII, we will attempt to look into the future and try to outline what Europe might be like in 2020. This is not as visionary as it might seem at first sight, since some important long-term processes mentioned before are already at work in Europe. European integration will have a major influence on the size and shape Europe will take about 20 years from now. If all goes well, we may expect a currency union or a euro area comprising up to 30 countries with a combined population of about 400 million. On the other hand, considerable challenges can be expected and a linear extrapolation of the European unification process can by no means be taken for granted. Read up on the prospects or scenarios that experts see for European history in the upcoming two decades.

The euro area as it exists today is being supported by efforts to deepen the European Union and to boost its competitiveness. These efforts at further integration of markets, liberalization and deregulation should persevere,

without jeopardizing social cohesion. In my view, this strategy is not only the most suitable response to internationalization and globalization, but also a bulwark against any manoeuvres to reverse liberalization in Europe. As to the single monetary policy, sticking to the primary objective of maintaining price stability remains a key factor for the credibility of the euro. Furthermore, we must continue to credibly observe the provisions of the Stability and Growth Pact, which is crucial for the smooth functioning of EMU. Countries that do not respect the Stability and Growth Pact and the Maastricht Treaty will face the stipulated consequences, otherwise our credibility could slip.

We are looking forward to the medium-term prospect of a number of new members joining the euro area. These countries, of course, will have to fulfil the same conditions of EMU accession as earlier members did, which are: entering the European Union, joining the exchange rate mechanism (ERM) II and participating for at least two years without problems, and fulfilling the Maastricht criteria in a sustainable way. These are sensible and sound milestones on the route to full monetary integration.

The need for other European policies, and especially economic policies, to accept the consequences of the single currency and to step in line with its requirements naturally leads to the issue of political governance in the European Union. There are a number of open, unresolved issues, especially questions about how far political and institutional integration is to progress. For me, EMU certainly is a harbinger of political union within Europe. As history shows, national territories and currency areas are, as a rule, identical. For this reason it is fundamentally important that national interests be overcome and that cooperation between member states must be reinforced.

European integration will only be successful if it reaches out to the whole of Europe. It is the concept of stability orientation that urges us to complete European unification. If we manage the enlargement process successfully, this will also be conducive to our endeavour to guarantee stability for the European Union. Such a mutual improvement is desirable in a very broad sense: political stability, macroeconomic stability, financial market stability and – in the particular interest of the Eurosystem – price stability. It is now up to all of us to continue along this successful path.