

Preface

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2004 saw the completion of the fifth EU enlargement since 1972 as eight Central and Eastern European countries and two Mediterranean islands became members of the European Union (EU). This was an unprecedented event in EU history, both with respect to the number of countries and the number of citizens newly integrated into the EU at one go. Enormous, ongoing political and institutional efforts have paved the way for this development that was all but inconceivable 15 years ago.

Mirroring this process, a wide range of economic questions have emerged. Some are fundamental ones, mainly related with the transition process as such. Others have a clear link to the macroeconomic policy framework set up by the old EU member states. Several questions have been solved in the meantime; privatization, for instance, is no longer a major issue. But at the same time new challenges have appeared on the horizon, reflecting different adjustment speeds across sectors, a lack of macroeconomic policy coordination or newly arising conflicts of interest.

Right from the beginning of the transformation process, the Oesterreichische Nationalbank (OeNB) has closely followed issues on Central and Eastern Europe that were perceived as important from a central banker's view. Austria's historical links and its geographical situation may have been the first incentives to do this. Nowadays economic considerations prevail, as trade relations, foreign direct investment (FDI) patterns, and developments in financial markets, especially the banking sector, clearly signal that Austrian firms were quick to take advantage of this opportunity to expand into neighbouring countries. As a result, Austrian companies now hold above-average market shares, which makes it necessary from an analytical, and advisable from a supervisory point of view to keep following developments in this region closely.

This book contains contributions made to the East–West Conference that the OeNB organized together with the Joint Vienna Institute (JVI) in November 2003. The conference focused on several topics of proven

relevance for a successful transition process. High-ranking representatives from international institutions and well-known academics shared their views and contributed their expertise in these areas.

To single out a few topics, a discussion of human capital and capacity building challenges highlights the labour market issues involved. In this area the gap between the supply and demand of well-trained people has narrowed only slowly, even when elder generations are excluded from the sample. Hand in hand with the ongoing up-grading of the labour force nominal wages are catching up, making the task of keeping wage increases in line with productivity even more difficult. However, compared with the levels prevailing in the old EU member states, unit labour costs will remain much lower for quite a while, so that these countries will hold their position in the international division of labour and still attract FDI in the foreseeable future. Interestingly, FDI is not spread evenly across Central and Eastern European countries and, vice versa, not all Western industrialized countries have become engaged in the region. Instead one can find a clustering behaviour of different sectors and industries. Moreover, FDI flows have declined recently, indicating that the big-ticket investments have been made and that the big companies are passing on the baton to smaller and medium-sized companies. From a macroeconomic viewpoint this increases ongoing worries about the existing current account deficits.

A discussion of fiscal policy issues underlines the necessity of coordinating macroeconomic policies at a national level. Recent experiences have impressively shown how broken public sector commitments can disturb market expectations and result in capital outflows and speculative behaviour. It has to be kept in mind that while offering opportunities, newly liberalized capital markets also create risks if accompanied by unsound and incredible macroeconomic policies. Yet, overall, there is firm evidence that financial markets in Central and Eastern Europe have performed well. The Austrian banking sector, which has become a major player in many of these countries, has contributed to this development, and Austrian banks generate a significant share of their earnings in this region. Given that the variety of financial products is still limited in the acceding countries, these markets offer a lot of potential. At the same time, the lack of liquidity, which reflects the smallness of these countries, is difficult to overcome.

Monetary integration is perhaps the most interesting part of the ongoing transition process. This statement reflects not only a biased central banker's view. The adoption of the euro has also become a major issue in the current political debate in many Central and Eastern European countries. Without any doubt, by adopting a common currency, a country gives up one of its

strongest policy tools, thus limiting future possibilities to adjust competitiveness. The success of this undertaking will depend on responsible decision-making and a thorough process of economic analysis. To answer the related questions about how to optimally time Exchange Rate Mechanism (ERM) II entry and which exchange rate may be adequate is not an easy task. Given that the newly acceded countries are still on a catching up route and that those decisions are hence embedded in an even more complex target function, they can hardly be compared with the challenges created by the first round of monetary integration.

Yet the debate about the euro is not limited to such economic issues because first, the relation between a nation and its currency tends to be an emotional one, widely used in the electoral process, and second the euro appears to be a symbol for successful integration. As the economic facts and analyses call for caution, the countries should carefully weigh the pros and cons of taking this final step. At any rate they would be well advised to wait until it became clear that EU enlargement did not cause a major external shock.

To sum it up, this book tries to give insights into past, current and coming issues related with the EU enlargement process. Joining the European Union is only one of several goals, many of which have been reached but some of which are yet to be met. Nevertheless, the process of catching up has not yet been completed and issues of convergence, driven by different base lines, deviating cyclical positions or asymmetric shocks, will continue to appear on the European agenda.

