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AUSTRIA´S EXPERIENCE ON THE ROAD TO EUROPEAN INTEGRATION

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Conference on Payments Systems on the Threshold of EU

Although I am not an expert on payments systems, more on European integration in general, it was with a great pleasure to accept your kind invitation to address such a distinguished Hungarian audience and to speak about the Austrian experience with European integration.
For me as an Austrian citizen, Hungary stands as the accession country which has opened up its economy as one of the first and is today among those already closest to the EU.
Both Hungary and Austria have benefited from this openness and will continue to do so – if possible, even more – when Hungary joins the EU in 2004.

Austria`s Experience with European Economic and Monetary Integration

This leads me to Austria’s position in the European monetary integration and to a brief review of our experience with the first three years of EMU:

- In the post-war period and after a period of devaluation of the Austrian Schilling, Austria chose the right policy mix to successfully re-establish monetary and economic stability and has managed to uphold this stability ever since.

  This process was a vital lesson for Austria: monetary reform and a restrictive economic policy course were required to contain high post-war inflation; as wage and price agreements no longer proved sufficient to keep inflation at bay.

The Federal Act on the Oesterreichische Nationalbank, adopted in 1955, reflected this negative experience with inflation: it contained provisions to grant the oeNB greater independence and to oblige the OeNB to pursue price stability long before these notions became common currency for central banking legislation around the world.

When the Bretton Woods System broke down for good in 1973, Austria had to decide on a monetary regime for the future, and in the years that followed, Austria opted for what became known as the hard currency regime.

Long before the concept of stabilizing expectations became a tenet of the European Monetary System (EMS) at the European level, Austria's monetary policymakers chose an external nominal anchor and a cooperative, consensus-oriented monetary, income and structural policy approach. In view of our positive experience with the hard currency policy, the advantages of deeper monetary integration were especially manifest for Austria.

The careful sequencing of capital movement liberalisation in Austria between 1986 and 1991 demonstrate that foreign exchange transactions can be liberalized smoothly and without entailing monetary crises and systemic instability on financial markets – provided the domestic authorities have adequately prepared the process and that a country's economic fundamentals are sound.

Austria encountered no difficulties when it joined the EMS at the beginning of 1995, as it continued to peg the schilling unilaterally to the Deutsche mark, and this link was tighter than the fluctuation bands within the EMS.

This success story of the stability-oriented monetary policy culminated in a smooth irrevocable fixing of the exchange rates of the euro area currencies on January 1, 1999, at the onset of Stage Three of Economic and Monetary Union.

- But Austrian economic policy makers accomplished another important step in the past decades when they succeeded in opening up Austria´s markets and in subjecting the economy to international competition.

  Nevertheless, in Austria government intervention efforts remained strong into the 1980s and even 1990s, when other Western nations had already scaled back state intervention. But the re-orientation, which had begun slowly in the 1980s, gathered speed in the mid-1990s. A time, when Hungary was also well on the way to liberalisation and privatisation.

- Overall, Austria's political and economic integration into the international community made steady progress, and you might have found many similarities in Hungarian developments. But, of course, Hungary had and has a much shorter time span in which to progress towards European integration.

  With economic ties becoming stronger and with the process of European integration gaining speed, the realisation that Austria could not afford to remain on the political sidelines finally clinched the breakthrough to EU membership in 1995.

Austria thus achieved its goal of having a say in EU development rather than being a mere observer. This principle manifests itself best in Economic and Monetary Union – the area in which European integration has progressed furthest. Every member of the Eurosystem participates in the person of the National Bank Governor in monetary policy decisions according to the principle "one person, one vote".

- Summing up the Austrian integration experience, my message to you is: European integration cannot be achieved at a certain point in time but is a process, which starts long before actual EU-membership and continues when already being an EU member.

Austria and EU integration – A Comparison

If we compare these post-War developments in Austria with the progress in European integration, we may observe analogies as well as disparities.

- With a learning curve steepening over the years, Austrian and EU policymakers alike came to emphasize monetary stability as an economic policy priority. In other words, drawing on many years of experience, European countries have learned to orient their monetary policies on price stability, and countries that pursued an exchange rate anchor did so entirely without an autonomous monetary policy.

  Hence years of practical experience and preparation preceded actual Monetary Union, which is based on an independent system of central banks whose policy is oriented on price stability and on irrevocably fixed exchange rates between the participating countries. With its “hard currency policy”, Austria acted as a trailblazer for these developments. It is interesting to note that both the EU and Austria deliberately employed monetary policy as a catalyst for economic reform. The hard currency policy, which represented a structural stimulus, as well as nominal convergence in the EMS and later in EMU have been such driving forces. Even so, Austria and the other EU Member States recognized the limits this strategy came up against in a world of liberalized capital transactions.

The logical response was to back market sanction mechanisms by explicit rules, above all in the area of fiscal policy, by coordinating wage policies and by initiating economic reform measures.

- This leads me to the second aspect of my comparison between developments in Austria and the progress of European integration, namely the attitude towards free, open markets.

  Austria shares a basic scepticism toward giving market forces too free a rein with many continental European states. Among other things, this scepticism is expressed in the emphasis on a "European model" for the economy, which differs from the "Anglo-American model" of a free market economy. Nevertheless, it is intriguing that in the past one and a half decades the EU has been shifting steadily toward the free-market concept. This may be seen against the background of "eurosclerosis," a catchword of the 1970s and a condition which lasted into the 1980s, of the unrelenting rise in unemployment in the 1980s and 1990s, and of stepped-up globalization.

The EU's Single Market program and the economic policy programs designed to support Economic and Monetary Union clearly point the way toward a strengthening of market forces and a restriction of discretionary macropolicies. Like many EU Member States, Austria took this path toward a market economy not so much by choice as by the need to respond to external demands.

The strength of the link between the European economic policy reform process and monetary policy entails the risk that not meeting publicly declared targets will damage the currency's standing. Against this background, it is crucial for the future development of EMU and the euro that the stability-oriented foundation of EMU, e.g. the absolute priority that monetary policy accords price stability or the importance of the Stability and Growth Pact for budget policies continues to be upheld.

- A third angle for a comparison is the approach to European integration itself.

  After World War II, the European "core countries" very quickly occupied themselves with the project of European unification, driven by the ambition to promote reconciliation through integration and cooperation. Phases of expansion and deepening followed the foundation of the European Union at various intervals.

  Considering that European integration is quite a difficult process on the whole and that individual Member States' conceptions of the future of the Union are very different, the tenacious progress of this integration process is indeed extraordinary.

Austria entered the European integration process at a relatively late stage. While the effort to join a larger Europe - first as a member of the European Free Trade Association EFTA, and later as an EU member - was soon part of Austria's integration program, whole-hearted participation in European integration took some time. I believe, that now, that Austria is a member of both the EU and the euro area, it has taken this decisive integration step. The enlargement of the European Union – a step of great and historic significance for Europe and for Austria – will place our country even more squarely at the heart of this integrated Europe, geographically speaking.

Opportunities and Challenges for Austria`s Economy

From the Austrian economic perspective, EMU is tantamount to a 35-fold increase in the size of the common currency area to over 300 million consumers. This opens up new perspectives and the opportunity to proactively address the challenges of globalization and heightened competition. The new framework benefits first and foremost the small and medium-sized enterprises (SMEs) in industry and trade, the pillars of growth and employment in the Austrian economy.

To illustrate the change, according to the most recent figures, some 60% of Austria's imports came from euro area countries in 2001, and some 56% of its exports were delivered to the euro area. Foreign trade with the euro area has, of course, been greatly facilitated by the single currency and by cost savings as a result, above all because there is no longer any exchange rate risk and because transaction costs are lower. Austria is doing very well in international markets: At nearly 34%, Austria recorded the highest export share of GDP ever in 2000. This ratio had come to only 25% when the country joined the EU and had risen to just under 30% before participation in EMU.

Turning briefly to the developments during the first three years of EMU, they bear impressive testimony to the fact that the smooth interplay between monetary and fiscal policy provides a solid foundation which was well suited to weathering the economic policy challenges of this period. Monetary Union and the euro have kept the euro area countries from being exposed to harmful intra-European exchange rate tensions of the type that many countries used to suffer when external shocks occurred. It has become quite obvious that Austria's inclusion in the stability-oriented Economic and Monetary Union has protected our country from negative shocks much more adequately than was possible under past regimes.

Successful Euro Changeover

Since March 1 of this year, all legacy currencies of the euro have been phased out and new euro banknotes and coins have become the legal tender in 12 of the 15 Member States of the European Union (EU). Today, more than 300 million citizens in Europe share the same currency. The process of monetary integration as laid down in the Maastricht Treaty has found its tangible expression and culminating point in the everyday life of the citizens of the euro area. From my point of view this historic cash changeover has been completed very successfully with the broad sometimes even enthusiastic support of the European citizens.

The changeover of the old national banknotes and coins of the 12 countries of the euro area has been a highly challenging project - and its success has far exceeded our expectations. This is also true for Austria, where we had an exceptionally successful cash changeover.

The elimination of exchange rate risks and lower transaction costs - visible in the narrowing of bid/ask-spreads - which already followed the introduction of the virtual euro in 1999 have conferred tremendous advantages on European businesses and consumers. Now we have the chance to promote the creation of more transparent markets and new opportunities for businesses. The euro will force firms and banks to attain higher levels of efficiency and competitiveness. In return, banks and companies are profiting due to bigger markets, improving financing conditions and a new variety of financing options.

With regard to financial services and payments systems the implementation of single market directives and the Euro will lead to more transparency and comparability of price structures. So, for consumers it will be a lot easier to make informed choices. This, in turn, may lead to substantial price decreases. On the other hand, cost reduction will be achieved by new technologies, alliances within the banking sector and institutional integration.

The euro as a catalyst of financial market integration

I would like to turn to the effects of EMU toward greater financial stability. Given the size and the economic clout of the single currency area in Europe, the stability-oriented institutional framework of EMU and the growing integration of the financial markets of the participant countries, the euro stands every chance of becoming a currency of global importance. And in fact, the euro rapidly established itself as one of the leading investment, trading and issuing currencies. The euro is one of the principal currencies on the forex markets, and Euro/U.S. dollar trade is by far the most active trading segment. In addition, the euro has become a premier issuing currency.

In short, the Euro - building on the single market in financial services – has become a catalyst for change in the integration of the up to then largely fragmented European financial markets. Capital can be allocated more efficiently, euro area financial markets have gained significantly in size and depth.

Generally, the implementation of monetary policy in the euro area has proved highly efficient in fostering financial market stability. The Eurosystem has successfully introduced a market-oriented, modern and flexible operational framework. The money market has clearly benefited from this in its refinancing operations. Short-term interest rates have totally converged and the money market within the euro area has become fully integrated.

In the bond market, too, the Euro played and of course continues to play a crucial role in fostering a deeper and more liquid market. Investors too, have gained access to a wider spectrum of investment opportunities. According to BIS statistics, the Euro's share in net issuance in the first three quarters of 2001 amounted to 44 %, which is almost as high as the share of the US-dollar, namely 48 %.

The Euro has become the second most widely used currency as a result of the overall weight of the euro area economy in the world. When we look at the official international use, the euro is second only to the US dollar among the world's official reserve currencies. According to the latest available data, the Euro accounted for around 13 % of the world's official foreign reserve holdings, compared with a US dollar share of around 66 % or the pound sterling and yen, which amount to about 5 % each.

However, we still face challenges of extending and solidifying the benefits of the euro to all segments of the financial market. Short-term securities markets or repo markets denominated in Euro are still insufficiently integrated. Similar to other areas of the EU, several obstacles have to be removed to end those fragmentations. To name just a few of them: Heterogeneous national infrastructures of the market, different regulatory, and legal regimes or varying market practices still impede full financial integration. It is our own interest that the European banking system and its financial markets integrate further. For you as market participants, this would entail the liquidity benefits of deeper and wider markets and lower transaction costs.

The international role of the Euro: a stabilizing influence

The Euro also has a stabilizing influence on the international financial system. This stabilizing influence will be felt most distinctly in those countries closest to the euro area such as the countries currently conducting accession negotiations with the European Union, thus creating a zone of stability that is even larger than the euro area itself.

Let me therefore look beyond the confines of the Eurosystem and the European Union – and develop some thoughts about the role of the euro in the context of European Integration.

For the monetary policies of Central and Eastern European countries, the Euro is a key currency already today. In most of the monetary policy strategies of Central and Eastern Europe, exchange rates play a vital role and, wherever they are not a formal or informal intermediate target, they are at least a key monetary policy indicator. In nearly all cases it is the Euro upon which the Central and Eastern European currencies are oriented, or to which they are formally linked. As a result, the Euro will also gain importance as an intervention and reserve currency in the region. On a microeconomic level the Euro has, of course, a certain role to play as a cash currency in Central and Eastern Europe.

Looking ahead one of the challenges is, of course, to achieve economic and monetary integration of the accession countries in a successful way. There, the Union and the Eurosystem will have to proceed in three steps. In a first step, the candidates will accede to the European Union, then they will participate in the ERM II, the exchange rate mechanism of the Union, and finally, they will introduce the euro as their national currency.

Beyond EMU – Further Political Integration and Enlargement

EMU represents a quantum leap in integration, a key step in completing the Single European Market. Of course, competition is most pronounced within EMU itself. Monetary Union - and only Monetary Union - guarantees that the Single Market can utilize the full potential of its economic power on the basis of a stable common currency and that the growing pressure of international competition on Europe is buffered.

The deepening of the European Union that accompanies EMU and the euro is therefore not simply the most suitable response to internationalization and globalization, but also a bulwark against any maneuvers to reverse liberalization in Europe. Deepening of European integration is crucial especially for small open economies like Hungary and Austria.

The single currency holds out the promise of fostering European integration in areas far beyond Monetary Union. Of course, there are many questions about how far political and institutional integration is to progress. We will probably have to wait until the events of the next few years and the next Intergovernment Conference in 2004 provide us with the answers to these questions.

What is certain, however, is that EMU 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 in favour of a single European policy and that the co-operation between Member States on a common foreign and security policy and internal security policy be reinforced.

We can therefore, only welcome the EU's special constitutional convention . The assembled politicians and officials have the task of proposing a concept of the EU which will match our continental dimension and the requirements of the 21st century. I acknowledge that this convention is a bold experiment in consultative democracy.

After successfully implementing EMU, the next major challenge Europe faces in the upcoming years is certainly the successful integration of accession countries. The enlargement project is just as impressive and far-sighted as EMU, and it also holds out enormous opportunities - as well as challenges that must not be underestimated.

This project seamlessly continues a European integration process, which was initiated with the foundation of the European Coal and Steel Community in 1951, continued with the establishment of the European Communities and the European Union, created one of the world's biggest markets and has for the time being culminated in the introduction of the euro, a stable currency that has established its reputation around the world.

These integration steps were of great significance for our continent; they supported the political and economic stability of Europe, increasing security and welfare for every citizen and strengthening Europe's role in the world. Hence I am firmly convinced that a diligently prepared enlargement of the EU will go down in European history as a very positive step toward integration.

European integration will only be truly 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 endeavor to guarantee stability for the whole euro area. Such a mutual improvement is desirable in a very broad sense: price stability, financial market stability, economic and - in the particular interest of the Eurosystem – political stability.

Conclusion

In concluding I would like to reiterate that in many respects, Monetary Union and the euro have proved to be a driving force for Europe's continued economic and political integration. The euro will play a central role as a catalyst for the future economic and political integration of Europe, as an international stability anchor and finally as a token of identity for a modern, dynamic, open Europe.