

Klaus Liebscher: The euro and European integration – an Austrian viewpoint

Luncheon speech by Dr Klaus Liebscher, Governor of the Austrian Nationalbank, at the International Bankers Forum, Luxembourg, 9 April 2002.

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Introduction

It was with great pleasure that I accepted your kind invitation to address such a distinguished audience and to speak about the Austrian experience with European integration. In former times, Luxembourg has had a very turbulent past - often triggered by the Habsburgs - with countries taking turns in slicing pieces off the Grand Duchy. After World War II, however, Luxembourg together with the other founding countries of what is now the European Union (EU) symbolizes the building of a united Europe carried out in a spirit of negotiation and dialogue.

For me as an Austrian citizen, Luxembourg also stands for all of the benefits especially smaller countries can derive from the EU. It may still be the tiniest state of the EU according to size but Luxembourg is also one of its most prosperous ones. The Grand Duchy is one of the three institutional centers of the Union and very often feeds new elements into the debate of and about the EU and as a result helps bigger countries to reach agreement. Thus, Luxembourg enjoys an influence in the EU beyond its small size and is an example of European co-operation at every level.

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 - and often 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 Austrian population accepted the new currency with unforeseen enthusiasm from the very beginning.

Before the introduction of euro banknotes and coins, the public - not only in Austria - had some concern about potential inflationary effects due to the rounding up of prices, long queues in shops because of the new banknotes and coins or a reluctance to purchase consumer goods due to the new price levels. None of that in fact happened to a significant extent.

As far it can be assessed today the contribution of the cash changeover to the increase in inflation in January and February is negligible. Indeed, rounding happened in both directions, up and down. And so far we have very little evidence of effects of the cash changeover on the average level of prices, neither in the euro area nor in Austria. This, of course, will not make us complacent, and we will continue to look vigilantly for the possibility of an impact on inflation rates in the months ahead. Over the medium term, however, downward pressures on prices should predominate within the euro area.

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 to attain higher levels of efficiency and competitiveness. In return, companies are profiting due to bigger markets, improving financing conditions and a new variety of financing options.

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:

- Following the turmoil and privation of World War II and the post-War period and the ensuing devaluation of the Austrian schilling, Austria chose the right policy mix to successfully reestablish monetary and economic stability and has managed to uphold this stability ever since. This process was a vital lesson for Austria in more than one respect: An incisive 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, which was 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 policymakers 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 far into the 1980s and even 1990s, when other Western nations had already scaled back state intervention. But the reorientation, which had begun slowly in the 1980s, gathered speed from the mid-1990s.

- Overall, Austria's political and economic integration into the international community made steady progress, which represented an additional aspect of the reorientation.

With economic ties becoming stronger and with the process of European integration gaining speed, the realization 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, in that every member of the Governing Council of the ECB participates in the monetary policy decisions of the Council according to the "one person, one vote" formula.

Austria and EU integration – a comparison

If we compare these post-War developments in Austria with the progress in European integration, we will 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 orchestrating structural policy measures.

- This leads me to the second aspect of my comparison between developments in Austria and the progress of European integration, namely the attitude toward 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, of stepped-up globalization, but also of the economic prowess the United States exhibited in the 1990s.

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, 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 diverge, 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 EC member - was soon part of Austria's integration program, whole-hearted participation in European integration was a while in coming. 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 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.

Not only did EMU and the euro improve the external economic environment, it also required business and industry to make incisive operational and technical changes. Companies had to establish new strategic positions on their markets and had to adjust to the more intense competition, which has shifted more and more to quality considerations.

The euro and the Single Market have boosted product and service innovation in many areas and have thus added to Europe's competitive strength.

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. Some of you may have not so fond memories of the EMS crises of the years 1992 and 1993. 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.

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 Austria and Luxembourg.

By introducing the euro, European economic policymakers have assumed the responsibility for exploiting the opportunities and for addressing the challenges this move represents for Austria or Luxembourg and for Europe as a whole.

We must continue to observe the provisions of the Stability and Growth Pact, and we must demonstrate the ability to solve integration and structural policy problems to boost our international competitiveness.

The single currency holds out the promise of fostering European integration in areas far beyond Monetary Union. Of course, this chance manifests that 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 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.

I therefore, 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.

However, we need to define what kind of institutional arrangements will be prerequisite to meet our aspirations, what kind of society and what kind of economy we want to build. I also do not think that the real question is of federalism versus national sovereignty. The EU is federal already. It divides power between different levels of authority. The questions now are over the most effective and legitimate way to divide that power, so that national sovereignty is preserved within an integrated system. If those questions can be resolved, Europe will earn the voice it seeks on the world stage.

This, however, does not mean that we have to give up our national identities. Their roots go very deep, and it is absolutely in the European Union's best interest to preserve specific national and regional cultural traits. "Unity through diversity" is certainly an advantage Europe has compared to other regions and economic areas. I am confident that - if we succeed in tapping the creative and problem-solving potential of Europe's diversity to work on reaching common goals - Europe and its countries face a bright future.

After successfully implementing EMU, the next major challenge Europe faces in the upcoming years is certainly the enlargement of European Union. This integration 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 an 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: political stability, financial market stability, macroeconomic and - in the particular interest of the Eurosystem - price stability.

EMU and the euro are Europe's strategic response to global competition and the associated challenges it poses. EMU underpins Europe's role in the international polity and strengthens the position of our economy in the face of growing international competition.

It not only triggered monetary convergence, but a real convergence of our economies. Structural reforms geared toward efficient and flexible product, capital and labor markets, as well as sounder fiscal policies have made our economies more shock-resilient and will ultimately increase our non-inflationary growth potential.

This positive and stabilizing influence is not only felt within the euro area, but also in those countries that have close ties to the euro area, such as the countries currently conducting accession negotiations with the EU. Thus, with the euro as a stable anchor, EMU creates a zone of stability that is even larger than the euro area itself.

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. It is now up to all of us to continue along this successful path toward European integration, not merely to preserve what we have already reached, but to actively contribute to the development of a bright future for our Europe.