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### **Austria's Approach towards the European Union**

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# Austria's Approach towards the European Union

*Fritz Breuss*

## 1. Introduction

As an EU "greenhorn" one easily forgets the pains and troubles on the road to Europe. The history of European economic integration tells us that one needs a long breath in order to be eligible as EU member. And when you are a member the paradise is not around the corner. For instance, it took Spain nine years to become a member of the European Community (EC), Austria needed five and a half years to be in the European Union (EU)<sup>1</sup>.

In my contribution I will tell in short the long story how Austria approached the European Union (EU). For other EU applicants this may not serve as a model blueprint, but it shows the particular problems a country has to tackle with when engaging to become a member of Europe's mightiest economic powers.

Austria's roads to Europe were by no means straight. In contrast, we made many roundabouts and sidesteps. This, however, is not a problem unique to Austria. The double-trackedness of European integration in the sixties (EC versus EFTA integration) has caused enormous frictions and inefficiencies which resulted in a sub-optimal growth process in Europe and unused welfare potentials. In the case of Austria one can demonstrate that the splitting of integration in Europe was not very helpful for Austria's economic development.

The steps of Austria's integration into Europe cannot be understood without looking at the historical background in Europe in general and Austria's special situation in particular. The State Treaty and the Neutrality status of 1955 precluded an EC membership from the beginning which meant that the EFTA membership was the only option. After the breakdown of

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<sup>1</sup> After the Treaty on European Union (TEU) or the "Maastricht" treaty came into force on November 1, 1993 one generally speaks about the European Union (EU). Strictly speaking this term is only applicable if one speaks about the political dimension of the Union (the "second" and the "third pillar" - the Common Foreign and Security Policy (CFSP) and the Cooperation in Justice and Home Affairs (JHA)). In the connection of the "first pillar" - Single Market and European Monetary Union (EMU) one speaks of the European Community (EC). Generally, if one addresses future aspects one speaks of the EU, if one talks about the period before Maastricht one uses EC.

communism in Eastern Europe in 1989 in Austria a radical rethinking of its position in Europe led the government to apply for EU membership.

## **2. Austria's Roads to Europe**

### *2.1 EFTA Membership*

#### **2.1.1 The Sixties: A First Attempt to Approach the EC**

The creation of the European Coal and Steel Community (ECSC) in 1952, in particular the Treaties of Rome (European Economic Community and Euratom) in 1957 by six states (Belgium, France, Germany, Italy, Luxembourg and the Netherlands) set the foundation of an split in European integration. The other OEEC countries (Austria, Denmark, Great Britain, Norway, Portugal, Sweden, Switzerland; later other countries joined the club: 1970 Island, 1986 Finland, 1991 Liechtenstein) reacted by creating the European Free Trade Association (EFTA) in 1960. By the way a customs union (EEC) and a free trade association (EFTA) is in conflict with the most-favoured-nation principle of GATT (since 1995 WTO). Both forms of regional integration only benefit its members on the costs of the non-members. GATT in its article XXIV, however makes an exception for both integration forms.

The general understanding of the EFTA states was that their goal will be to become members of the EEC. And this goal should be reached in common. However, on July 31, 1961 Great Britain - and immediately followed by Denmark, Ireland and Norway started the first attempt to break out of the EFTA group. They applied for EEC membership. In reaction to this step the three neutral states, Austria, Sweden and Switzerland, applied for an association status (Article 237 EEC treaty) with the EEC on December 15, 1961. At that time it was common opinion that a neutral state could not become an EEC member. After the French veto against negotiation with Great Britain in January 1963, Austria was the only country of the three neutrals to stick to its association application. In diplomatic circles one called this attitude "Austria's solo" (Alleingang Österreichs). In summer 1967, after continuous bomb terrorism in South Tyrol Italy vetoed Austria's solo approach towards the EEC.

In the case of Austria it can be demonstrated that the schism of integration policy in Europe (EEC versus EFTA) in the sixties was inefficient measured by trade and growth (and hence welfare) performance (Breuss, 1992a, 1993). At the beginning of EEC and EFTA integration, in 1960 50.3% of Austria's total exports went into the EC, in 1972 only 38.7%. In contrast, the export share with the EFTA increased from 13.2% to 29% (see figure 1).

The loss of competitiveness on the EC market is reflected in the development of market shares. In 1960 Austria's EC market share amounted to 1.8%. In 1972, after 12 years of discrimination it came down to 1.2%. In the same time Austria's position improved on the preferred market of the EFTA from 0.6% to 1.9%. As a consequence of the asymmetric market power of the small country Austria and the powerful EC bloc the share of imports from the EC in total imports remained nearly unaffected (1960: 56.5%, 1972 58.9%). Imports from the EFTA, however, increased as expected from 12.2% to 18.8%.

Austria's non-participation in the EC in the sixties was very hard because it hindered the natural neighbourhood trade with Germany and Italy. EFTA membership was only a second best solution. On the one hand the market of the EC is much larger than that of the EFTA, on the other hand Austria had to redirect its trade flows from the neighbours to the far-distant EFTA countries in Scandinavia and in Portugal.

Integration theory (more precise the theory of customs union by Jacob Viner) isolates three static integration effects: a customs union (and in analogy also a free trade area) leads to trade creation between the member states; the common commercial tariff shields the customs union from imports from third countries (trade diversion); for the consumers a customs union is welfare improving because the abolition of tariffs within the union makes intra-union goods cheaper. In the case of Austria, the trade creation effects (measured by the additional imports from the EFTA) between 1960 and 1972 amounted to 0.13% per year (table 1). Trade diversion effects (measured by the reduction of imports from the EC) had about the same magnitude. If one also adds the trade diverting effects in trade with the rest of the world the trade diverting effects (0.23% per year) surpassed the trade creating effects in the sixties (Breuss, 1993, p. 471).

The overall impact of the conjectured losses through the frictions of non-EC membership in the sixties are very difficult to isolate. The growth dynamic in this period, however may shed some light on this conjecture (table 2). In the early post-war period (1955/60) real GDP grew by 5.5% per year in Austria and hence with the same rate as that of the EC. During the period of separated integration in Europe 1960/73 Austria's GDP growth of 4.7% per year was lower than that in the EC (+4.9%). A similar pattern can be found in the development of GDP per capita. This lagging-behind of Austria's economic development may be interpreted as the growth (and hence welfare) losses due to the non-EC membership (table 2). Calculations with an integration model (Breuss, 1993) strengthen this point. Accordingly, Austria's non-EC membership may have cost 0.12 percentage points of GDP per year. In contrast, the growth effect of EFTA membership was moderate (0.04% per year; table 1).



### **2.1.2 Austria's Reintegration into the EC via the Free Trade Agreements of 1972**

After the futile "roundabout" of EFTA integration in the sixties the free trade agreements of EFTA countries with the EC and with the ECSC in 1972 led back to the natural trade relations - in particular in the case of Austria. Starting in 1973 trade in manufactured goods between EC and EFTA were liberalised gradually. Till mid 1977 (for some sensible products only in 1984) all bilateral tariffs were eliminated. Since then one can speak of a free trade area between both integration blocs. Whereas trade in manufactured goods was completely liberalised agricultural trade was still managed between EC and EFTA. In the so-called "agricultural letter" of 1972 the EC and Austria agreed upon the rule that bilateral agricultural trade relations should be "harmonic", meaning that there should be no disequilibrium in the bilateral trade balance. In fact, Austria's trade balance in agricultural trade with the EC deteriorated, starting in the seventies. In 1994, the agricultural trade deficit with the EC amounted to 13 bill.ATS.

The free trade agreements undoubtedly had positive results for Austria. The share of exports to the EC-6 increased from 38.7% in 1972 to 55.7% in 1994 (see figure 1). In 1994, 62.9% of Austria's exports went into the EC-12. The EFTA lost its attractiveness for Austrian exporters. In 1972 Austria exported 29% of total exports to EFTA-8, in 1994 only 13.3% went into this region (the export share with EFTA-5<sup>2</sup> was only 8.9%). The gradual elimination of Austria's discrimination on the EC market is manifested in the increase of Austria's market position in the EC. The market share in the EC increased from 1.2% in 1972 to 2.6% in 1994 (EC-6). On the market of the EC-12<sup>3</sup>, Austria held a market share of 2% in 1994.

It is remarkable that the free trade agreements did not enable the EC-6 to further improve its position in Austria. Whereas in 1972 the share of imports from the EC-6 amounted to 57.9%, it increased till 1994 only to 59.5%. Imports from EC-12 occupied a share of 65.9% of total Austrian imports in 1994. The importance of the EFTA as a trading partner shrank considerably. While Austria imported from EFTA-8 18.8% in 1972, this share decreased to 11.1% in 1994 (EFTA-5 6.8% in 1994).

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<sup>2</sup> In 1994, the EFTA comprised 7 members: Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland. The foreign trade statistics treats Liechtenstein and Switzerland as one country.

<sup>3</sup> After three enlargements, the EC counted 12 members in 1994: Belgium, Denmark (1973), France, Germany, Great Britain (1973), Greece (1981), Ireland (1973), Italy, Luxembourg, Netherlands, Portugal (1986), Spain (1986).

The fact that Austria regained competitiveness after the tariff discrimination on the EC market is mainly due to the revival of neighbourhood trade. Germany became the dominant market for Austria's products. In 1972 22.4% of Austria's exports went to Germany, in 1994 the share was already 38.1% (without the Ex-GDR trade 36.8%). The import relations remained nearly unchanged. In 1972 Austria imported 41.9% from Germany, in 1994 40% (without the Ex-GDR trade 39.5%). Trade relations with Italy, however, could not regain the level of 1960 (export share 9.6% in 1972, 8.1% in 1994). Imports from Italy increased slightly (from 7.2% in 1972 to 8.8% in 1994).

In the case of Austria, the reintegration in Europe (EC with EFTA via free trade agreements) also strengthened the business cycle fluctuations (Breuss, 1994c). Besides stronger integration (elimination of tariffs), the major cause was the close links of the Schilling with the D-Mark since 1981 ("hard currency" policy).

The removal of the frictions in trade between EC and EFTA via the free trade agreements was one factor why Austria could gain growth and welfare effects since 1973. The elimination of trade discrimination led to a redirection of Austria's trade flows from the EFTA towards the EC - which was welfare improving. Since 1973, the trade creating effects amounted to 0.18% of GDP per year (measured by the additional imports from the EC), the trade diverting effects were only -0.05% of GDP per year (resulting from the decline of imports from EFTA; see table 1).

As a consequence of more exports to the large EC market production was stimulated. According to model simulations (Breuss, 1993) the free trade agreements added to GDP growth 0.24% per year since 1973. This simulated dynamic integration effects match quite well with the actual lead in average annual GDP growth Austria had over the EC in the period 1973 to 1993 (see table 2).

## *2.2 As EFTA Member Participating in the EEA*

On January 17, 1989, - in a fundamental speech in the European Parliament - Commission's president Jacques Delors proposed the European Economic Area (EEA) as a way to prevent EC enlargement. The best proof that his strategy did not succeed is the recent fourth EU enlargement by Austria, Finland and Sweden. Sometimes it was proposed that the Central and Eastern European countries (CEECs) should first go through the EEA waiting room and only after that experience become members of the EU. But none of the CEECs is willing to do this! On March 15, 1989 the EFTA states on their conference in Oslo, took up the offer by Jacques Delors and initiated the so-called Oslo-Brussels process at a meeting of foreign

ministers of EFTA and EC. On July 1, 1990 the negotiations for the EEA started in Brussels (Hummer, 1996, p. 23).

The idea of the EEA was born at the conference of foreign ministers of the EC and EFTA states on April 9, 1984 in Luxembourg. This meeting was the first common meeting after 25 years between EC and EFTA officials. In the conclusion of the conference ("Luxembourg declaration") a program for the so-called "second-generation" cooperation between EC and EFTA was proposed which should lead to a "harmonised European Economic Space" - later called EEA. However, the future of this proposal was clouded by the fact that the Commission's "White Paper on the completion of the single market"<sup>4</sup> - only for the EC member states - was already published on June 14, 1985 (EC, 1985). The goals of the White Paper were implemented as an amendment to the EC Treaties by the Single European Act (SEA), coming into effect on July 1, 1987. By the SEA the EEC treaty of 1957 was amended for the first time. For the single market the deadline was set of December 31, 1992.

The EEA is an association agreement between EC and EFTA states and forces the EFTA states to take over a large part of the *acquis communautaire* but without having equal rights as the EU members in developing new EU law. The aim of the EEA treaty is the implementation of the major parts of the single market also for the relations between EU and EFTA states. This means the implementation of the "four freedoms"-free movements of goods, of services, of capital and of people. However, the EEA is missing some components in order to be a complete single market. The EEA did not result in the creation of a customs union between EC and EFTA and hence, there is no common commercial policy and no common external tariff in the EEA. This implies that border controls are still necessary for transactions between both integration blocs. As far as agricultural policy is concerned - with the exception of the liberalisation in trade of some goods - there is no integration into the common agricultural policy of the EC. Unfortunately no harmonisation between the EEA and the Europe Agreements in the case of the rules of origin (an essential part of the intra-EFTA trade) and in the case of passive processing - which is important in trade with the CEECs - was established in the EEA. Therefore some essential ingredients for a free movement of goods and services are missing in the EEA treaty. The most important harmonisation concerns the competition law. In the EEA the rules of competition are the same. Although two different institutions are responsible for controlling the

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<sup>4</sup> Single market and internal market are interchangeably used in English.

obedience of the competition law: in the EC the European commission and in the EFTA the EFTA Surveillance Authority (ESA)<sup>5</sup>.

Originally, it was the idea that EC's single market and the EEA will come into force on January 1, 1993. While the single market started at that date, the negative referendum in Switzerland in December 1992 delayed the implementation of the EEA. Only after renegotiations of the EEA (without Switzerland but with Liechtenstein) the EEA treaty was set into force on January 1, 1994. After the EU accession of Austria, Finland and Sweden, the EEA on the part of the EFTA only consists of three members (Iceland, Liechtenstein and Norway).

In Austria, there was little euphoria, neither political nor economic for being in the EEA. Because of the 2/3 legal single market solutions the estimated integration effects were moderate. If Austria had stayed in the EEA, according to model simulations with the WIFO macro model (Breuss-Schebeck, 1991; Breuss, 1994a), real GDP would have increased in the medium run by 2 1/4% (cumulative after six years). Due to a fiercer competition one would have expected that the price level would be down in the same period by 3 1/2%. Austria always pointed out that the EEA is no more than a "training camp" for EU membership.

### **3. The Preparation for EU membership**

#### *3.1 Austria's Integration policy after the Announcement of the Single Market Project*

The publication of the EC Commission's "White Paper on the Completion of the Single Market" in 1985 in Austria resulted in a longer phase of meditation. It was not clear how to react to the new challenge of European integration. The major handicap for an EC membership seemed to be, as before, the neutrality status of 1955. On the one hand the dramatic changes in the world - in particular the break-down of communism and consequently the collapse of the USSR (one of the four signatory powers of Austria's states treaty) - and on the other hand the implications of non-participating in the future European integration process, documented by new studies, led to a turn-around in the public opinion in Austria. Already in 1987 an international law study demonstrated, how it was possible to join the EC, even for a neutral state (Hummer-Schweitzer, 1987). The first economic studies (Breuss-Stankovsky, 1988) on the possible outcome of different integration scenarios (non-membership versus EC membership) led to the

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<sup>5</sup> In its first annual report 1994 ESA (1995) documents the experiences of the member states.

conclusion that economically, a deepening of integration is better than staying out.

The first very detailed simulations with the WIFO macro model (Breuss-Schebeck, 1989) made it clear: in case of non-membership, Austria's economic development would lag behind that of the EC. Whereas the "Cecchini report" estimated the creation of the single market to be resulting in an cumulative increase of real GDP of the EC by 4 1/2% after six years, Austria's real GDP would - via passive demand spill-overs - only increase by 1 1/2%. That implied that the growth dynamic would fall behind that of the EC. Also the difference in the price performance - and hence in the welfare effects of the consumers - would be considerable. In case of non-membership, the price level in Austria would be lower by 1 3/4% after six years - mainly due to the price spill-overs (assuming that Austria's sticks to its "hard currency" option) of the lower price level in the EC because of the creation of the single market - leading to a drop in the price level by 6 1/4% after six years in the EC. In case of EC membership, a fiercer competition would also lead to a stronger price decrease in Austria (by 5 1/4% after six years) and real GDP would be higher by 3 1/2%.

This message, published early in February 1989 was well understood by the Austrian politicians. After reaching a consensus within the social partners (chamber of commerce, chamber of labour and presidential conference of chambers of agriculture) and within the coalition government of the Socialist party and the Peoples party, it was officially announced that Austria would join the EC. On July 14, 1989 the Austrian foreign minister Alois Mock submitted the EC commission the formal letter of EC application. This date is interesting also insofar, as Austria decided to join the EC, before the USSR collapsed. Only in the autumn of 1989 the Berlin wall cracked. Then, in rapid succession, all former USSR satellites became independent, the USSR collapsed and hence also the COMECON.

The Austrian government pointed out in its letter of application that it would stick to its international status of political neutrality. In his letter of confirmation, on July 17, 1989 the Council president, Roland Dumas mentioned that the Council took notice of Austria's wish to remain a neutral state.

### *3.2 The Avis by the European Commission*

Each application for EU membership is answered by the Commission with an economic and political evaluation - called "Avis". The Avis on Austria's application was ready on July, 1991 (two years after formal application; Avis, 1991). The commission applauded Austria's overall economic performance. Measured by the data of 1991 Austria would have fulfilled the

so-called Maastricht convergence criteria! In a comparison of the most relevant macroeconomic indicators (GDP growth, inflation rate, unemployment rate, current account position and net lending) Austria's performance was better than that of EC-12 (Breuss-Schebeck, 1992). Due to the relatively faster growing economy in Austria compared to the EC average - in particular since the early seventies (see table 2) - enabled a rapid catching-up process in Austria's GDP per capita. In 1960, Austria's GDP per capita was 11% (measured with PPPs) lower than EC-12 (or 16% lower, measured at constant 1985 ECU prices). In 1990 Austria reached EC-12 average (PPP measure) or surpassed EC-12 average already by 13% (at 1985 prices). According to the most recent data for the year 1994, Austria is the third richest country in EC-15 (see tables 3 and 3a).

Whereas the Commission emphasised positively the balanced macro-economic policy mix (in particular the corporatistic approach of wage-price negotiations by the social partnership) and the hard-currency policy for stabilising the economic development, it criticised the fiscal and structural policy. In particular the danger of losing competitiveness should be counteracted by improving productivity and more flexibility on the labour market. The Avis also identified sectors with a low degree of competitiveness (or high degree of oligopoly) - in particular in the service industries (commerce, banking, insurance) - or with a high degree of regulation (public enterprises, as the postal service, the railway company etc.). Such monopoly rents are one explanation why the level of prices were higher for many products and services as in Germany.

After indicating the changes Austria would have to make when becoming a member of the EC in many fields of economic policy (trade, agriculture, regional, competition, taxes), the Avis analysed in detail the different sectors and the necessary adjustments to the EC standards. The net contribution to the EC budget was estimated at that time to be 12 bill.ATS, based on data of 1990/91. As we will see later, the actual net payments in 1995 were 15.6 bill.ATS.

The general conclusion of the Avis can be summarised by saying that Austria was highly welcome for economic reasons (as a net contributor to the EC budget), but that the Commission envisaged future problems with Austria's political neutrality status. However, these problems were qualified as solvable.



## 4. The Negotiations for EU Membership

### 4.1 *The Accession Treaty of April 1994*

The European Council on its meeting in Edinburgh on December 1992, decided to start negotiations with the four EFTA candidates Austria, Finland, Norway and Sweden on January 1, 1993 (Itzlinger, 1996). On February 1, 1993, the negotiations started with Austria, Finland and Sweden; Norway followed on April 5, 1993. After formulating its positions for the negotiations with the European Commission Austria agreed with the Commission to base the negotiations on a list with 29 chapters (see table 4). The first 14 topics were more or less already covered by the EEA treaty. The remaining chapters covered the content of the EC treaty. The last chapters (from 23 onwards) were topics of the Maastricht treaty which was not yet ratified at the time of the start of negotiations. When the TEU (Maastricht treaty) came into force on November 1, 1993 these chapters were dealt with in the negotiations. In particular, it were the chapters of European Monetary Union (EMU) (23.), Common Foreign and Security Policy (CFSP) (24.) and Cooperation in Justice and Home Affairs (JHA) (25.).

The negotiations were structured in the following way (Woschnagg, 1996, p. 131): The negotiations between the four EFTA candidates and the EU took place under the umbrella of a "conference on the EU accession". This conference was either a meeting on the level of foreign ministers or their representatives (ambassadors). The results of the negotiations, separate for each of the four EFTA states but parallel in time, were documented in a common "Accession Treaty" of April 12, 1994. This treaty covers not only the results for Austria but also for the other three EFTA countries.

In general, each member of the EU after Maastricht has to take over the whole *acquis communautaire* (two thirds of which was already content of the EEA treaty) and the full content of the Treaty of European Union (TEU) - the Maastricht treaty - which means participating in all three pillars - EMU, CFSP and JHA. However, it would not be the European Union, would one not take care of the special problems of each member state. The EU made Great Britain and Denmark concessions for real concessions (social charter and EMU for Great Britain and EMU for Denmark), and it took into consideration specific problems in Austria and in the other EFTA countries. These concessions are formulated as transitional conditions in separate protocols to the "Accession Treaty". Protocol 9 deals with the specific transit problem Austria has (in particular in the case of the north-south traffic via Tyrol). This protocol substitutes the rules under the EEA treaty and defines the regulations concerning the transit quota in connection

with the ecological impact of this traffic. This transitional transit rules will phase out by the year 2001. Protocol 10 has more a peculiar character. With a list of 23 food products it defines the notions in two kinds of German - in Austrian and in German German! Both expressions may be used for the same product in official German EU documents!

#### *4.2 The Referendum in June 1994*

According to Austria's constitution - Article 44 - a fundamental change of the constitution has to be submitted to the electorate in form of a referendum. Austria's population voted overwhelmingly pro EU membership (66,6%) in the referendum on April 12, 1994. Finland followed on October 16, 1994 with 57% pro membership, Sweden on November 13, 1994 with only 52%. Norway voted - for the second time on November 28, 1994 (the first was in 1972) with 53% against membership (Breuss, 1995a). EU membership is only coming into effect if the European Parliament and each of the 12 old EU member states ratify the "Accession Treaty" of Austria, Finland and Sweden. On May 4, 1994 the European Parliament ratified the accession treaties for the four EFTA candidates. 374 members of the European Parliament voted in favour of Austria (24 no, 61 abstentions). Norway (374 yes, 24 no, 58 abstentions), Finland (377 yes, 21 no, 61 abstentions), Sweden (380 yes, 21 no, 60 abstentions).

On the European Council at its meeting in Korfu on June 24, 1994, the "Accession Treaties" with the four EFTA candidates (Austria had already passed the positive referendum) were signed by representatives of the 12 old EU members and those of the four new EU candidates.

By the end of 1994 all 12 EU member states except Spain had ratified the "Accession Treaties" of the three EFTA countries. Spain blocked the ratification process because of a dispute on fishery quotas in anglo-irish fishery zones. This dispute was settled at the latest possible date, on December 22, 1994.

#### *4.3 Legal Adjustments - Constitutional Changes and the Austrian Parliament*

Austria's EU membership has caused the biggest change in its constitution since its implementation on October 1, 1920 (except the World War II period, 1933-1945). At least four of the six basic principles of the Austrian constitution had to be changed (democratic principle, separation of powers, federal principle, rule of law). As a corollary the Austrian constitution had to be changed by six new articles. Under the new heading "European Union", Article 23a deals with the elections for the European Parliament. For a transition period Austria has delegated its 21 EP members by the Austrian Parliament. On October 13, 1996 for the first time, Austria's members in the EP are elected directly by the Austrian population. In Article 23b additional conditions for the EP members are defined, if civil servants and university professors are elected. Article 23c defines the conditions for the appointment of members in the institutions of the European Union (Commission, Court of Justice etc.). Candidates for these

institutions are nominated by the federal government. Article 23d rules the information duty of the federal government against the "Länder". Article 23e defines the rules for participation of the Austrian parliament in the decision making process of the Austrian ministers in the Council of ministers. Before an Austrian minister attends a Council meeting in Brussels he or she has to inform the Austrian Parliament and seek an accord about the "Austrian position" on the specific topic<sup>6</sup>. Article 23f talks about Austria's participation in the "second" (CFSP) and the "third" pillar (JHA).

## **5. EU Membership Since January 1995 - Expectations and Reality**

An analysis of the motives of the referendum of April 12, 1994 revealed that the majority has voted for membership because of the expected economic advantages of being integrated in a larger market. In the short run these expectations have been disappointed. The reason for the frustration of Austria's population about EU membership one and a half year after EU accession may be found in the mismatch between government propaganda and scientific estimations of integration effects. Scientists have always pointed out that the positive integration effects - if there are any - will only materialise in the medium and long run. In the short run, the adjustment and learning costs are higher than the welfare effects. It seems that these general timing pattern of integration is even more pronounced the less developed a new EU member is.

### *5.1 Increased Unification of Economic Policy since EU Membership*

#### **5.1.1 General Remarks on the Autonomy of National Policy**

EU membership means the take over of the legal status of the EU. This implies primary law (Treaty on European Union - TEU - the Maastricht Treaty - and hence the renewed EC Treaty) and the secondary law (acquis communautaire) in the form of Regulations and Directives as well as the Judgement of the Court of Justice (ECJ). With the EU membership Austria - according to the TEU, in force since November 1, 1993, takes actively part in the continuing integration process on the basis of the concept of the "three pillars":

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<sup>6</sup> While some authors (Griller, 1995) criticise this procedure as practically not feasible, the president of the Austrian parliament (Fischer, 1996) is very fond of the involvement of the parliament in the decision making process of EU law.

- Pillar I: Economic and Monetary Union (EMU) - of which the single market, coming into force on January 1, 1993 is one part.
- Pillars II and III: The Common Foreign and Security Policy (CFSP) and the cooperation in Justice and Home Affairs (JHA).

The EU is a community based on a harmonised body of law which is valid for all member states. Exceptions are only made in justified cases. By this idea a fair framework with solidarity and equal rights should be the basis for economic and political activities. Transitional regulations in the case of Austria were defined in the Accession Treaty of April 12, 1994.

As a characteristic feature of increased integration the degree of autonomy in economic policy decreases while the need for political harmonisation and unification increases. The free trade association EFTA allows its members to be autonomous in nearly all fields of economic policy. This was one of the reasons why the neutral states became members of EFTA. In the European Economic Area (EEA) the EFTA states already took over two thirds of the *acquis communautaire* of the EU. The most prominent field was the common competition law. In the EU most of the political areas were harmonised or unified already before the Maastricht treaty (e.g., the Common Commercial Policy, the CAP, common competition policy, common regional policy). In the near future the EU will turn into EMU with a common currency (Euro) and a common (centralised) monetary policy by the European Central Bank (ECB). According to statements of the former president of the European Commission, Jacques Delors and of the Commissioner Martin Bangemann - already before the Maastricht treaty - in Germany, nearly 80% of all regulations concerning economic law were initiated by the EC (Breuss, 1994 b, p. 112). Austria is not the only EU member, which has not yet transformed all Single Market Directives into national law. According to the European Commission (EC, 1996, pp. 10 ff.), at the end of 1995 276 regulations were in force, 222 need national conversion measures. In 1995, on average of the EU-15, 93.4% of the necessary national implementation measures were taken in order to implement single market law. However, the degree of conversion varies between countries: Denmark (99.1%), the Netherlands (97.3%), Spain (96.4%) and Sweden (96.4%) are ahead of EU-15 average (93.4%). Greece (89.6%), Germany (88.7%) and Austria (87.4%) are below average. Finland already converted 94.9% of the necessary directives into national law.

The other side of the coin of a diminished degree of the autonomy in national policy making is the increased power of creating economic policy on an European level. In the institutions of the EU (European Parliament, Council, Commission, Court of Justice, Court of Audit, Economic and Social Committees) small EU member states - compared to their size in

population and GDP - are overrepresented (table 5). This, however, may change after the Inter-governmental Conference (IGC), which started in March 29, 1996 in Turin. The questions of newly organising the EU institutions and hence also the future weighting scheme of votes are a central topic in the IGC '96. The urgency of the solution of these democratic and political questions (Falkner-Nentwich, 1995) is well understood if one thinks of the next EU enlargement (besides Malta and Cyprus) ten Central and Eastern European countries (CEECs), which are more or less small and less developed economies (Breuss, 1995b; Breuss-Schebeck, 1996). With the Maastricht Treaty the principle of "subsidiarity" was explicitly considered: The responsibility of the EU member states comes into effect in those cases where the interest of the community is low.

### **5.1.2 Dramatic Change in the Regimes of Commercial and Agricultural Policy**

The accession to the EU causes the alignment of nearly all legal, institutional and political activities to EU rules. In the case of economic policy, the most dramatic change concern those fields which are so-called "unified" policy areas: the Common Commercial Policy, the CAP and the regional policy. In the competition policy Austria already participated in 1994, when being a member of the EEA. Only the relevant institutions changed - from the ESA to the European Commission. As a new member Austria is also integrated in the finance system of the EU. These abrupt system changes left their deep marks in the respective economic areas in 1995.

#### *5.1.2.1 Common Commercial Policy*

By entering the EU, Austria made two steps at once (Breuss, 1995b; Griller, 1995). One step concerned the handing over of competence for commercial policy to the European Community. The other step was the taking over of the Uruguay Round obligations of the EU. Austria entered the Common Commercial Policy of the EU, which implies participating in the EC customs union. In contrast to the EFTA, which is a free trade area, in which each member state can define its external tariffs autonomously, the EC has been a customs union with a Common Customs Tariff (CCT) since it started in 1958. Austria, traditionally a high tariff country, had to reduce its MFN (most favoured nations) tariff level of 10.5% (on average of manufactured goods) to the lower level of the EC (5.7%) and also to adjust other instruments (quotas, "local content" arrangements with Japanese car makers, etc.). The obligations of the Uruguay Round imply that the CCT have to be reduced by 37% in the next five years (until the year 2000). In the case of Austria, the isolated effect of this tariff reduction results in an

increase of real GDP of around one percentage points from 1995 to 2000 (Breuss, 1995b, Breuss-Kratena-Schebeck, 1995).

The change in the trade regime, in addition to the take over of the CCT of the EC implies also serious consequences for the Austrian foreign trade statistics (Richter, 1996; Breuss, 1996c). Since the abolition of the border controls and the participation in the single market, it has no longer been possible to statistically ascertain the flows of trade from and into the EC at the border. Therefore, two kinds of foreign trade have to be taken into account, the extra trade (trade with non-EC member states) and the intra trade (trade with EC member states). Trade flows with third countries are still controlled at the border and treated statistically as usual (EXTRASTAT). Trade flows with EC partners are measured by the firms (INTRASTAT). The basis is a value added relevant sale or a value added purchase in trade with the EC. After creating the single market in the EC intra-EC trade is - exactly speaking - no longer "foreign trade"!

Because of these troubles with these changes in foreign trade it is understandable that the data on foreign trade for the year 1995 are still incomplete and not comparable with the data of 1994. This implies also that an exact calculation of GDP for the year 1995 is not possible. According to estimates by the chamber of commerce, a first comparison of the regional trade flows of the first EU year 1995 with the year 1994 is made (table 6). Austria's exports increased (in nominal terms) by 11%, imports by 8.7%. The share of EU exports in total exports increased from 64.8% in 1994 to 65.4% in 1995, the share of EU imports increased from 68.4% to 70.2%. The shares with the other regions remained nearly unchanged. No significant trade creation vis à vis third countries (as one would have expected after the reduction in the tariff level) could be identified so far. The increase in imports from America was primarily caused by an appreciation of the Schilling against the Dollar. The exports towards Asia increased, imports from this region declined.



### *5.1.2.2 Common Agricultural Policy*

While the participation in the customs union of the EC had caused more administrative (statistical) than economic adjustments in Austria, the integration into the Common Agricultural Policy (CAP) was a major step with severe economic implications not only for the sector agriculture but also for the food industry. In Austria, because of its lower level of productivity and higher degree of subsidisation (Breuss, 1995b, p. 376)<sup>7</sup>, agricultural prices dropped immediately after EU accession to the lower level in the EC. This price shock would have implied tremendous income losses for the farmers of about 10 bill.ATS (Schneider, 1994, p. 55; Schneider, 1995). As a consequence, before the referendum on the EU membership the ministries of agriculture together with those of finance agreed upon an "Europe agreement" on April 22, 1994. Over four years (1995/98) transitional payments (devaluation of stocks; degressive transitional income loss compensation) to the farmers amounting to 117.2 bill.ATS were envisaged, part of which (54.5 bill.ATS) were taken over by the EU. As a consequence of these transitional subsidies the farmers could compensate their income losses of 28% in the first year in the EU (Schneider, 1995). According to Eurostat (18/1995) agricultural producers prices were stable in EU-15 on average (-0.2% in real terms; deflated by the CPI). In the new member states prices dropped strongly (in Austria by 23.2%, in Finland by 26.3%, in Sweden only by 3%). The input prices declined slightly in EU-15 on average (-0.9%), in Austria by 1.1%, in Finland by 20.4% and they increased in Sweden by 3.2%.

The change in the agricultural regime from national agricultural (subsidy) policy to the unified regime of the CAP the welfare position is changing. Before EU membership the high subsidies for the farmers were paid by consumers and by the government. After EU accession the consumers gain welfare (at least after the transitional period) because they pay less subsidies, the food prices are lower. For the Austrian government there is a change in payments: the direct payments to the farmers are now substituted by payments into the EU budget, from which the CAP is financed. In the long run the producers (farmers) are the losers, except they are able to compete with the farmers in the other EU countries.

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<sup>7</sup> Measured by the Producer Subsidy Equivalence (PSE), estimated by the OECD, Austria was subsidising its agricultural production (56%) stronger than the EC (48%). The difference in the PSEs is a hint on the difference in the price level (Breuss, 1995b, p. 376).

### 5.1.2.3 Interaction of Regional, Industrial and Competition Policy

After EU accession structural and regional policy is based on common EU rules. The unification of the structural policy is not only important for an intra-country competition in the race for industrial locations but also for a similar intra-Austrian competition for industrial location of firms. Structural and regional policy aims at helping underprivileged regions under the heading of "economic and social cohesion" (Article 130a to 130e EC treaty). As the third richest country, Austria will get EC financial support in the period 1995/99, amounting to 1.623 mill.ECU (22.3 bill.ATS; Breuss, 1995a; Mayerhofer, 1995). This support has been agreed upon in the Accession Treaty. Austria has one objective area 1 (Burgenland) and several objective 2, 5a and 5b regions<sup>8</sup>. The difficulties in changing a country's structural policy are highlighted by the fact that Austria did not get any financial support in the first year of accession, in 1995. The relevant documents were agreed upon between the Austrian representatives and the European Commission only by November and December 1995 (Tondl, 1996). Thus, money flows are due only in the following years. By the participation in the EC regional policy, Austria may be able to increase its investment expenditures for regional projects compared to the possibilities it had before EU membership (Tondl, 1996).

Competition policy is an essential precondition for the functioning of a market economy. Already in the EEA treaty, the rules of competition policy were harmonised between the EFTA states and the EU states. The substance of competition policy hence remains unchanged, although the legal basis has changed (now the EC treaty, before the EEA treaty) and the responsible institutions are different (ESA in the EEA, European Commission in the EU). The basic activity of the European Community is defined in Article 3(g) EC treaty as "a system ensuring that competition in the internal market is not distorted". The example of competition policy shows that integration effects need time to become effective. Enterprises and consumers have to learn the rules of the game of a free market competition. In a small market like Austria, direct imports are therefore a legitimate means of consumers to exhibit pressure on the hitherto oligopolistic behaviour of many firms.

Many unified policy areas of the EU are interwoven with each other. One example of such an interdependence are those of competition, regional and industrial policy. Public aid is the essential interface. The regional policy defines the objective areas (1 to 5b), which in turn allow specific amounts of subsidisation. Industrial policy is regulated in Article 130 EC treaty. Major objective is the improvement of competitiveness of the industry in

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<sup>8</sup> For a definition of the different objective areas, see Breuss (1995a), p. 112.

the Community. The concrete design of industrial policy, however, again are public aids. Either it consists of general subsidies, which are allowed generally (in case of SMEs - small and medium size enterprises; research and development, environment) or sectoral aids (exceptions for the ECSC, shipbuilding, car industry, textile and clothes).

## *5.2 EC's Single Market: Expectations and Reality*

### **5.2.1 In the European Union**

Based on an extensive survey of European companies in the manufacturers and services sectors, in 1988 the so-called "Cecchini report" estimated the "Cost of Non-Europe" (Emerson et al., 1988). Taking these estimates as input Catinat-Donni-Italianer (1988) with macroeconomic world models simulated the macroeconomic impact of the single market for the EC-12 in a period of six years. The complex integration effects of the single market were reduced to four categories: 1) the abolition of border controls, 2) the liberalisation of public procurement, 3) the liberalisation of financial services (banking, insurance), 4) supply side effects (economies of scale and a general intensification of competition in the EC). The single most important contribution comes from the supply side effects, second comes the liberalisation of financial services. In total, real GDP of the EC-12 should increase by 4.5% after six years of experimenting with the single market (that means,  $\frac{3}{4}$  percentage points more GDP per year). Increased competition in the single market should lead to a drop in the price level by 6.2% after six years (or one percentage point per year). Concerning the competition effects, the Smith-Venables (1988) doctrine has become popular within the microeconomic model builders. The theoretical essence may be summarised as follows: multinational European firms had played the following price segmentation strategy: on the home markets they were oligopolists and on the foreign markets they behaved like perfect competitors. This implied that the price level was higher in the home market than abroad. The abolition of border controls and a harmonised competition policy (with an effective control by the European Commission and its merger control body since 1990; EC, 1994) should lead to an equalisation of prices throughout the single market. However, the pressure to reduce costs via economies of scale could lead to further concentration (mergers and acquisition) in Europe. If the merger control by the EC is not very effective, this could lead to results counterproductive to the original single market goals: European firms would behave like oligopolists on the EC single market (with higher prices than expected) and as perfect competitors on the world market. This would imply that the EC consumers would lose

welfare and those outside the single market (on the world market) would gain welfare due to creating the single market in Europe! (Breuss, 1996e).

When commenting this outlook one should also mention the problems on the labour market. Firms in the EC-12 also prepared for the new conditions of a borderless single market with increased competitive pressure by reducing costs in form of utilising economies of scale and by increasing productivity. This process of preparation for the challenge "single market" can easily be verified by looking at the increased foreign direct activities in the years 1986 to 1990 and the increased number of mergers and acquisitions within the EC. Due to a tremendous adjustment shock (via increasing labour productivity in order to reduce internal costs in the firms), employment was expected to decline in the short run. Catina-Donni-Italianer (1988) estimated a decline of employment of 573.000 persons within two years (in the years 1993 and 1994) which implies an increase in unemployment. The break-even point - where increased demand on the goods markets also leads to an increase in employment - may have been reached in 1995. In the face of the actual situation in the EC with increased unemployment and the danger of a recession, one has problems to believe the expected positive growth and employment effects. One should, however, do justice to the estimations by Catina-Donni-Italianer (1988) because they did not take into account the negative effects of the preparation for the EMU (synchronised restrictive fiscal policy in nearly all European countries in order to match the convergence criteria in 1997). This leads to the critique on the timing of European integration. Before the EC economies may profit from the positive single market integration, the next project - EMU - is launched. In this respect one has the impression that the EMU project comes too early for many EU member states (Breuss, 1996b).

The "new integration" effects of the single market (which are different and more complex to the simple tariff reduction effects of creating a customs union, like in the sixties) have the characteristic feature that in the short run adjustment costs (on the labour market, learning of the new rules of the game in competition) can be higher than the positive impact on reduced costs (abolition of border controls, harmonisation of technical norms) and prices. However, in the medium and long run, the positive impact of deeper integration surpasses the negative aspects because the intensification of competition leads to ever lower prices and hence increases welfare for consumers.

### **5.2.2 In Austria**

In Austria the estimation of integration effects is much more complicated than for the old EC-12 countries. While the EC-12 countries, which entered into the single market on January 1, 1993, already were EC members, Austria made several steps towards EU membership. In 1993, Austria was still a member of EFTA, in 1994 it participated in the EEA, and in 1995 Austria - together with Finland and Sweden - entered into the EU as a new member (Breuss, 1995a).

In principle, the considerations by Catinat-Donni-Italianer (1988) on the EC-12 are also applicable for Austria in the case of EU membership. As a newcomer, however, due to the adjustment to the harmonised policies of the EC, several additional effects have to be taken into account. Austria - more than the old EC countries - at first has to learn the new rules of the EC games. Therefore a differentiation in short-, medium- and long-term integration effects seems adequate. In table 8 one can find an overview of the kinds of integration effects Austria will be confronted with in this time frame. The adjustment costs (productivity shock, net contribution to the EU budget, internal budgetary burdens, conversion of national law to EC law<sup>9</sup> are felt in the short run. In the medium and in the long run the positive integration effects due to more competition and dynamic effects (investment) will show up.

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<sup>9</sup> The short-term learning costs in the case of adjusting Austrian law to the *acquis communautaire* can be illustrated by the fact that Austria will be confronted with three accusations before the European Court of Justice because of either not correctly transforming EU directives or not obeying EU competition law. 1) Austria is still sticking to the status of anonymity in case of opening of saving accounts. This runs counter the "Money Laundry" regulation 91/308 EC; 2) Austria violated the regulations concerning public procurement when being a member of EEA in the case of building a new local government centre in St. Pölten; 3) Austria has increased the toll for users of the Brenner highway by much more than the Council Directive 93/89/EEC of October 25, 1993 ("infrastructure costs directive") allows.



### 5.2.2.1 Overall Integration Effects

In several studies, WIFO (Breuss-Schebeck, 1989, 1991; Breuss-Kratena-Schebeck, 1994) tried to evaluate different integration scenarios: Non-membership, EEA membership, EU membership. In summing up these studies - which were carried out by using the WIFO macro economic model - one gets the following expectations of integration effects for the economy as a whole (tables 9 and 9a):

- *Passive participation in the single market:* In 1993, Austria was member of the EFTA. If the estimated integration effects for the EC-12 (increase in GDP, drop in prices) are materialised one can also expect that Austria via additional export demand should profit passively - although with a dampened rate - from the single market. In the year 2000 Austria's GDP would be higher by 1.7% as compared to an increase in real GDP in the EC-12 by 4.7%. If prices drop in the EC because of more competition, this will translate also in a decrease in Austrian import prices (given fixed exchange rates). Therefore, Austria's price level should drop by 2% until the year 2000 (compared to -7% in the EC-12). Non-membership, however, would hamper Austria's attractiveness as a location for foreign investors. Therefore, the investment dynamics would be deteriorated.
- *EEA:* In 1994 the EEA treaty came into force. Austria profited by the EEA membership via some additional effects (partial completion of the four freedoms; liberalisation of public procurement; harmonisation of competition policy; parts of supply side effects - economies of scale). Through the EEA status, interestingly, Austria did not attract more FDIs than before. As a result of model simulations the additional integration effects of the EEA participation are very modest: until the year 2000 an increase of real GDP of 0.2% and a drop in the domestic prices level (consumer price index - CPI) by 1.7%.
- *EU membership:* On January 1, 1995 Austria became a member of the EU. In addition to the effects which are pointed out by Catinat-Donni-Italianer (1988) for the old EC members states, Austria has to take into account additional effects of a newcomer. Austria entered into the customs union of the EC (Stankovsky, 1994). This implies a reduction of Austria's tariff level from 10.5% to the EC level of 5.7%. As a consequence import prices should go down slightly. In addition trade costs are reduced by entering the single market - due to the abolition of border controls and the harmonisation of other discriminating trade rules (rules of origin and passive processing when trading with the CEECs). A dynamic aspect of integration in the case of Austria is seen in the in-

creased attractiveness for foreign investors (positive location effect)<sup>10</sup>. In general, participating in the single market should have a price dampening effect and hence increase welfare of the consumers. Entering into the CAP system led to price decreases for agricultural products and also for food. In 1995 food prices dropped by 1.7% (of which basic foods such as milk, bread and butter etc. declined by 10.8%). This, and the increased competition in industrial prices led to a decline in the inflation rate from 3% in 1994 to 2.2% in 1995 (Breuss, 1996c). Austria is net-contributor to the EU budget by 15.5 bill.ATS in 1995. In addition the transitional income compensation payments by the federal government and the Länder caused a huge burden for the budget (see next chapter). Overall, the additional effects of EU membership (compared to EEA status) are estimated to result in an increase of real GDP until the year 2000 by 2.8% and a drop in the CPI by 3.3%<sup>11</sup>. If one adds up the effects of the three phases of Austrian integration since 1993 - EFTA, EEA and EU membership - one gets the following results for the year 2000: real GDP would be higher by 4.7% (as compared +5% in the EC-12), the price level would be down by 7% (-7.3% in the EC-12). This implies that Austria's integration effect converges over time to the EC-12 average (see figure 2).

The macroeconomic model simulations may underestimate the so-called "dynamic" integration effects, claimed for by Baldwin (1994). Accordingly, these effects result from an investment and hence GDP growth push because the single market (and later the single European currency) should improve the investment climate. The performance since 1993 raises doubts about this optimistic picture.

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<sup>10</sup> The locational aspect is more a long-term effect (Handler, 1996). In 1995 no significant influx of foreign direct investment took place (Breuss, 1996c).

<sup>11</sup> Keuschnigg-Kohler (1995) with a dynamic CGE model for Austria get similar results. They calculate a long-term increase of real GDP of 2.6%, but only a drop in prices by 1.5%. Neck-Schäfer (1994, p. 172) get somewhat different results by using the McKibbin-Sachs world macro model. EU membership results in a long-term increase of real GDP of 5.5% and a drop in prices by 4.2%. These results, however are effects of EU membership compared to non-membership.







#### *5.2.2.2 Sectoral Integration Effects*

As a rule, those sectors which were already exposed to international competition (which is true for most of the manufactures sectors) will exhibit no major changes through the accession to the EU. In those sectors which were protected (agriculture, food industry, services sectors - banks, insurances and commerce) one can expect big changes. On the other hand, changes in the trade regime (e.g., textiles and clothes profit from the abolition of disadvantages in the rules of origin and the passive processing rules) lead to an improvement in the position compared to the EEA status. Sectoral effects of Austria's EU membership are dealt with in several studies (Richter, 1993; Breuss-Kitzmantel, 1993; Breuss-Kratena-Schebeck, 1994; Breuss, 1995b; Keuschnigg-Kohler, 1995).

In all studies the agricultural sector is a loser in the short and in the long run. The following results are based on the study by Breuss-Kratena-Schebeck (1994) and are summarised in table 10. The simulations are based on the linked WIFO macro and input-output model. In the short run (1995) the production of the following sectors grows below average (less than 0.8% gross output): agriculture and forestry, mining, foodstuff, textiles and clothing, paper, chemicals, basic metals and energy). The other sectors - in particular the production of wood, stone and minerals, construction and those of all services sectors - will grow faster than the average as compared to the EEA scenario. A look at the actual performance of the industrial sectors in 1995 confirms more or less this pattern.

In the long run (until the year 2000) only agriculture and forestry, foodstuff, paper and basic metals lag behind the average production increase (+3.3%) due to EU membership. Increased competition, however, leads in the majority of the sectors to a sustained decline in employment.

### *5.3 The Budgetary Burden of Austria's EU Membership*

The European Union is not only an economic community but also a community of solidarity (Article 2 and 130a EC treaty - "...the Community shall develop and pursue its actions in leading to the strengthening of its economic and social cohesion."). In order to eliminate differences in the level of development of the different regions within the community, structural funds and since the Maastricht treaty also cohesion funds have been installed. The expenditures for the structural funds (31% of total EU budget) and for the CAP (50%) are the most prominent chapters in the EU budget. As a rule, the richer countries are net contributors to the EU budget and the poorer countries are net receiver of financial aids (estimates for 1995 see Breuss, 1995c, table 11b).

Originally, Austrian payments to the EU budget were estimated for the year 1995 to amount to 28 bill.ATS. The actual payments (except the capital contribution to the European Investment Bank -EIB) were only 24 bill.ATS in 1995. The difference was caused by lower than expected tariff revenues by 2 bill.ATS and a rebate of 2 bill.ATS because the EU distributed surpluses of the budget 1994 to its members. Future rebating can be expected because the expenditure for the CAP are declining after the successful McSherry reform of 1992. However, the management of the problem of the recent mad-cow disease in Great Britain may consume away a lot of this expected surplus. The EU paid back 10.1 bill.ATS to Austria in 1995 (table 11). According to the Accession Treaty, however, Austria should have received 17 bill.ATS. Because of the delayed acceptance of Austria's structural policy projects in November and December 1995 Aus-

tria did not receive financial aids from the regional funds in the year 1995. Only the payments for the CAP and the social funds flew back to Austria. The financial support for the regional projects, however, will be paid later.

Austria's net contribution to the EU budget amounted to 13.5 mill.ATS in the year 1995. This position appears as a deficit in the current account (position 3110: "Public fees to international organisations"). The capital contribution to the EIB of 2 bill.ATS are booked in the capital account of the balance of payments statistics (5970: "Other claims of the public sector"). Austria, being a member of the European Monetary System (EMS) since January 1, 1996 and taking part in the exchange rate mechanism (ERM) of the EMS since January 9, 1996 (Finland and Sweden do not yet participate in the ERM) has the obligation to deposit ECU reserves for intervention operations at the European Monetary Institute (EMI) in Frankfurt. The Austrian National Bank, therefore, made a deposit of 20% of its gold and US-Dollar reserves at the EMI. This position is booked in the balance of payments statistics as "9610 Claims against the EMI" (OeNB, 1996).

As the payments Austria gets from the EU are only passing through the Austrian budget, the gross contribution Austria made to the EU budget are the burden for the Austrian budget. If one adds up the transitional payments Austria made according to the "Europe Agreement" with the farmers, the costs of EU membership for the budget of general government amounts to 49 bill.ATS (or 2.1% of GDP) in 1995 (see table 11). This costs are shared by the federal budget and the budget of the Länder. Because of this contribution the budget of the Länder and cities exhibit -for the first time in the post-war history of Austria - a deficit. In 1995, net lending (total deficit of the Austrian public sector) amounted to 6.1% (5% federal government, 1.1% Länder and cities), 2.1% of which are attributable to the EU membership. According to figures by the ministry of finance the net contribution to the EU budget will increase over time and reach some 20 bill.ATS in the year 2000. As the transitional payments to the farmers decline after three years, the costs for the Austrian total budget will decline to around 30 bill.ATS per year in the year 2000.

Part of the additional cost of EU membership contribute positively to the integration effects (see table 9) according to the general Keynesian doctrine that an increase in public deficit increases aggregate demand (in our case in the areas of regional policy and in form of income transfers to the farmers). However, if the Austrian government cuts back its budget deficit in order to reach the convergence criteria in 1997 - as was done with the first austerity package in 1995 and now complemented by the 100 bill.ATS austerity package for the years 1996 and 1997 - the part of the income creating

effects implied in the original calculations of EU membership are compensated.

## **6. Austria Heading for European Monetary Union**

It would be an irony of history if Austria would not be a candidate for the European Monetary Union (EMU) in the first place. Austria performed much better in terms of exchange rate stability than many other EU countries (Breuss, 1992b). Since 1981 Austria has linked the Schilling to the development of the D-Mark. This so-called "hard-currency" policy meant that Austria formed already a (bilateral) monetary union with Germany, implying the same attributes which are due to the multilateral case of EMU: convergence of interest rates, inflation rates and also on many areas of macro variables (Breuss, 1992b, 1994). During the two crises in the EMS in September 1992 and August 1993 - where many EU currencies had to devalue (the British Pound and the Italian Lira had to leave the ERM) - the Austrian Schilling did not devalue but like the German Mark and the Dutch Guilder appreciate against the ECU. So Austria passed one test for EMU - stability of the exchange rates, also when the international capital market attacked weak currencies. According to this test criterium (Breuss, 1994, 1996e, 1996f) - without looking at the Maastricht convergence criteria - one could already identify a group of countries which could form the EMU: Germany, the Netherlands, Denmark, Belgium, Luxembourg and Austria. With the new austerity packages for 1996/97 the Austrian government is paving the way to reach the Maastricht convergence criteria, too.



### *6.1 The Maastricht convergence criteria in 1995 and forecasts for 1997*

One can speculate about more intelligent criteria for participating in EMU<sup>12</sup>. However, the TEU (the Maastricht treaty) defines exactly the convergence criteria (Article 109j and Protocol 5 and 6 EC treaty) which have to be met in order to become a member of EMU. These five criteria are: 1) price stability (an inflation rate of 1,5% above the average of the three lowest is tolerate), 2) public deficit of 3% of GDP or less, 3) public debt of 60% of GDP or less, 4) long-term interest rates (2 percentage points above those of the three countries with the lowest inflation rate), 5) keeping of the exchange rates within the "normal" bands of intervention within the ERM of the EMS in the last two years before examination (i.e., in 1996 and 1997).

The European Council, on its meeting in Madrid on December 15-16, 1995 defined the exact time table for the EMU. Accordingly, in spring 1998 the examination of the convergence criteria will lead to the selection of the group of EU member states which can start with the EMU in 1999. On January 1, 1999 the exchange rates of these group are fixed irrevocably. The European Central Bank (ECB) is established. Some transactions are already taken in the "Euro" the common currency in the EMU. On January 1, 2002 the first Euros are available for the public (bank-notes and coins). At the latest on July 1, 2002 the Euro substitutes completely the national currencies as legal tender. This time table, however, implies many question marks (see Breuss, 1996e, 1996f).

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<sup>12</sup> An extensive discussion about the theoretical foundation of EMU - in particular by the "optimum currency area" (OCA) theory, can be found in Breuss (1996e).



Taking into consideration available forecasts for the year 1997, one can guess who is eligible for EMU (table 12). Accordingly, if one strictly interprets the convergence criteria, only two countries - France and Luxembourg - would be candidates for EMU! This, however, would be politically not feasible and economically meaningless. Therefore, if one interprets the convergence criteria somewhat milder (according to the Article 104c) one comes to the conclusion that 11 countries would be eligible (Breuss, 1996e, 1996f). Two of which - Denmark and the United Kingdom - have opted out from being obliged to participate in EMU in the Maastricht treaty (Protocols 11 and 12 to the TEU). That means nine countries (including Austria) could start with EMU in 1999.

### *6.2 Problems on the Way to EMU*

The major risk of EMU lays already in the preparatory phase. Since at the moment all EU members states - except Luxembourg - miss the fiscal criteria (see table 12) an EMU race was initiated. All governments try to bring down their deficits and their debt quotas. Given the short period of time available (till 1997), this race may lead to a synchronised recession in Europe and hence the danger that no one will succeed in 1997.

Numerous studies tried to find out the impact of this budgetary policy race. In a study for the European Parliament, Barrel et al (1995) simulated the possible employment effects if all EU countries should fulfil the fiscal criteria until the year 2002. The outcome is gloomy. Employment in Europe would decline by 1,1 million persons. In contrast to this study an internal OECD paper (mentioned in Breuss, 1996b) designs a somewhat more optimistic outlook. After a period of decline of output and employment, there is a break-even point around the year 1999, when decreasing prices and interest rates, and lower budget deficits induce higher private demand and hence real GDP.

Whatever outcome may be, the fact that most economic research institutes made downward revisions of their recent forecasts for the years 1996 and 1997 indicates that two hard years are lying ahead of us.

### *6.3 Potential Costs and Benefits of EMU*

The costs (disadvantages) of a common currency are in losing the nominal exchange rate as an instrument for adjusting to external shocks. Therefore, incomes policy - which is an instrument of national macro policy - will become more important in the future in order to correct for external shocks and for disadvantages in competitiveness. In the case of Austria this implies that the importance of the social partnership will increase (Breuss, 1994, 1996e, 1996f).

The benefits (advantages) of having a common currency within the EU are manifold (Breuss, 1996f, table 7). The first advantage would be the reduction in transactions costs (costs of exchange money from one currency into another). This advantage - quantified to amount to ½ % of EU's GDP - is important in international tourism as well as in any other transactions of foreign trade. The elimination of the fluctuations of nominal exchange rates and of uncertainty about exchange rate changes should result in lower interest rates and hence stimulate investment ("dynamic" effects of EMU). Lastly the Euro could become a global medium of exchange and could compete with the US-Dollar as a world transaction and reserve currency. All these hypothetical advantages (inclusive economies of scale) are the more (the less) relevant the larger (the smaller) the number of countries which participate in the EMU.

## **7. EU's Eastern European Enlargement**

### *7.1 The Opening Up of Eastern Europe in 1989*

The collapse of communism in 1989 and the dissolution of the CMEA in 1991 led to a political vacuum in the trade relations between East and West. The EU filled this vacuum rather quickly by reorienting its commercial policy towards the CEECs. As soon as in 1989/90 it concluded trade and cooperation agreements with most of the CEECs, followed by Interim Agreements between the EU and certain CEECs as of 1992, regulating the asymmetric tariff reduction<sup>13</sup> for industrial goods (see Breuss, 1995c, tables 1 and 2). These Interim Agreements were the forerunners of the association agreements ("Europe Agreements"), which had come into operation as of 1994 and 1995 respectively for six CEECs. Economic relations have gained a new quality, as in addition to the intended liberalisation of East-West trade, certain elements of the Single Market conception have already been regulated (freedom of movement of goods and services, of workers, of establishment and some agricultural aspects). The European Agreements may be regarded as sort of pre-steps to participation in the Single Market, despite the fact that they ignore full harmonisation in the field of legal aspects of competition<sup>14</sup>. As a result of the Interim and Europe Agreements,

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<sup>13</sup> Breuss-Tesche (1994) made simulations of the effects of asymmetric tariff reductions in the case of Austria and Hungary.

<sup>14</sup> The Europe Agreements, however, already rule explicitly competition (Article 62 to 66) by referring to EC competition law. These regulations are similar to those of Article 23 in the Free Trade Agreements between the EC and EFTA of 1972.

East-West trade between EU and the CEECs in basic industrial products is free of tariffs (about 50% of the EU's imports of industrial goods from the CEECs) since January 1993. Trade barriers (tariffs and quotas) for certain sensible products and for steel, coal and textile and apparels will be abolished by 1996 and 1997, respectively. Analogous to the EU's efforts, the EFTA states, too, concluded free trade agreements with the CEECs, which have, however, a considerable lower quality of integration compared to the Europe Agreements.

There is no doubt, Austria is a winner of the opening up of the East. One year before the opening up, in 1988 Austria exported 9.6% to Eastern Europe (inclusive former USSR), in 1994 this share reached already 13.6% (the highest share after 1970 was attained in 1975 with 20%). In the same period, however, the imports from Eastern Europe increased not so fast (the import share increased from 6.9% in 1988 to 8.5% in 1994; highest share after 1970 was reached in 1984 with 12.1%). As a result, Austria gained a high surplus in the balance of trade with Eastern Europe (in 1994 16.5 bill.ATS), after years of balanced trade before the historic changes in the East (Breuss-Schebeck, 1995, tables 1, 2 and 3).

Simulations with the WIFO macro model (Breuss-Schebeck, 1995, 1996) exhibit, that the opening up of Eastern Europe increased real GDP, cumulated from 1989 to 1994 by 2.4%. Part of this positive effect is due to trade creation with Eastern Europe, part is a result of the indirect demand effects via the German unification and part is due to immigration. The isolated effects of immigration during the period 1989 to 1994 can be summarised as follows<sup>15</sup>: Austria's wage flexibility increased considerably. The strong influx of labour force during the years 1989 to 1992 (around 100.000 persons) soon entailed a distinct cut-down of wages. Compared to the baseline scenario, between 1989 and 1992 compensation per employees dropped by 2 1/4%. As a consequence, excess supply of labour could be partly absorbed. The downward pressure on compensation of employees cushioned the upward trend in prices, which led to a slight increase in total real demand. Until 1994, real GDP - due to immigration - rose by 0.2%. The sharp increase in unemployment (the unemployment rate increased by some 2 percentage points during this period) burdened the budget by rising unemployment benefits. However, with restrictions of access to the Austrian labour market some alleviation set in.

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<sup>15</sup> The microeconomic or sectoral consequences of East-West migration are demonstrated by CGE model simulations in the case of Austria-Hungary, assuming an immigration flow of 10.000 people from Hungary to Austria (Breuss-Tesche, 1996).

## 7.2 Cost and Benefits of EU's Eastern European Enlargement

The European Council at its Copenhagen summit in June 1993 made the basic decision that those associated Central and Eastern European countries (CEECs) which wished to enter into the EU are welcome. Conditions for membership are the implementation and acceptance of the *acquis communautaire* of the EU. At the summit in Essen in December 1994 the European Council offered the CEECs a "structured dialogue". The European Commission presented them a catalogue of tasks in the "White Paper on the Eastern Enlargement" of May 3, 1995, focusing on the legal preparation of becoming full members of the Single Market. At the summit of the European Council on December 15-16, 1995, for the first time, a vague date for the start of negotiations was mentioned. Six months after the end of the IGC - that means the talks on enlargement should start in 1998 - firstly with Malta and Cyprus, then with the CEECs. In the meantime most (nine) of the ten CEECs have officially applied for membership. They have either already put into force the Europe Agreements or are on the way to do so.

From an economic point of view the biggest hindrance of enlargement are the expected high costs. There are a lot of studies about these potential cost (a comparison is made in Breuss, 1996b). My own estimations are at the lower bound of these estimates (see table 13). Everybody agrees that the biggest hurdles are the integration into the CAP and - due to the low level of development of the CEECs - the costs for the structural funds. International calculations (Eurostat) and my own extrapolations (Breuss, 1995c, table 7) reveal that the poorest countries of the CEECs in the year 2000 are Romania (20.8% of EU-15 average), Lithuania (21.3%), followed by Bulgaria (25.8%), Poland (34.6%) and Latvia (34.9%). Hungary (42.1%), Slovak Republic (45.5%) and Estonia (46.3%) will nearly reach EU average in 2000. Two countries would already be above average (Czech Republic - 52.6% and Slovenia - 55.5%; see also table 3a for the year 1993).

With the help of a cross-section regression analysis one can extrapolate the potential cost of Eastern enlargement (see table 13). As a result, the total annual cost of the enlargement by ten CEECs would cost the EU some 30 bill.ECU (or 0.4% of EU's GDP or 31% of EU's total budget expenditures) in the year 2000. The highest cost stem from the CAP integration (12 bill.ATS<sup>16</sup>) and the structural funds (21.6 bill.ATS). It seems realistic that

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<sup>16</sup> In its first evaluation of the costs of enlargement for the CAP, the European Commissioner Franz Fischler estimated the budgetary impact at 12 bill.ATS per year after a transition period until 2010 (in an unchanged CAP; Agence Europe, No. 6615, November 29, 1995, p. 10). The costs for the year 2000 amount to some 9 bill.ECU.

not all ten CEECs are taken in the EU at once. The most advanced countries will probably be preferred. These are those countries with the highest GDP per capita and most successful in the transitional process from planned to market economies. Economically, the most prominent candidates are therefore the Czech Republic, Hungary, Slovenia, Poland and Slovakia. The net costs of these country group would amount to some 17 bill.ECU.

The benefits of enlargement are, however, distributed unequally between the EU countries. Those countries, which already trade very intensively with the CEECs - like Germany, Finland, Sweden and Austria - probably will gain the most. Those countries, which are less heavily involved in East-West trade like the southern countries of the EU would prefer more an intensification of the Mediterranean relations with the EU. The different economic impact of enlargement explains the different preferences revealed before the IGC started in Turin, on March 29, 1996. Accordingly, Spain, Ireland and Portugal are explicitly against enlargement. They see no positive direct effects for their economies and they fear that - in order to finance enlargement - the financial flows out of the structural and cohesion funds could be cut, which will be necessary anyway.

Simulations with the Oxford Econometric Forecasting (OEF) macro-economic world model indicate that a 10% sustained increase of Eastern European real GDP (this is the equivalent of the enlargement costs for the ten CEECs) results in GDP increases of between 0.1 and 0.5 percent in the western European countries depending on the trade intensities of the EU countries with the CEECs. (Breuss, 1995c, pp. 5 and 13-14). Austria would gain the most (0.5 percentage points additional real GDP cumulative over the period 1995 to 1999), Germany comes second with an increase of its GDP by 0.4%, followed by Italy, Belgium and Spain - each with an increase of GDP by 0.2%. Great Britain, the Netherlands and Sweden will gain only 0.1%.

### *7.3 The Impact of Enlargement on Austria*

In an attempt to quantify the impact of the Eastern enlargement on the Austrian economy, simulations with the WIFO macro model showed the following results (Breuss-Schebeck, 1995, 1996): The optimal package in the case of Austria is those of the four neighbours (Czech Republic, Hungary, Slovakia and Slovenia). The reason is that Austria trades most intensively with those countries (export (import) shares in 1994: Czech Republic 2.6% (1.8%), Hungary 3.9% (2%), Slovakia 0.9% (0.7%) and Slovenia 1.6% (0.7%) which sums up to 9% (5.2%)). In the case of an

enlargement by these four CEECs the cost of enlargement would be more than compensated by positive trade effects. Overall the simulation over the period 2000 to 2008 results in an increase of Austria's real GDP by 1.5%. If one adds Poland to this group, in the case of Austria the additional growth effects (+0.1% more GDP) would not outweigh the costs of enlargement. Any further extension is not very profitable for Austria's economy (+0.1% more GDP). In case of an enlargement of all ten CEECs Austria's real GDP would be higher by 1.7% after a nine-year period of integration (which amounts to no more than 0.2 percentage points GDP per year!). At least, the positive integration effects would compensate in the long run the costs of enlargement (see table 14).

## **8. Conclusions**

In a tour d'horizon this contribution tells the story of Austria's EU accession, its preparation, the short-run experiences with the EU and the expectations in the EU in the future. Whether the Austrian experience is an appropriate lesson for any other candidate is questionable. Each country has its own advantages and problems and hence, must adjust in an other way to the EU standards. Nevertheless, one can draw the lesson that even quite rich countries must have a long breath before being accepted in the EU. In the case of Austria, from the official application to the final accession it took five and a half years! This should not deter the not so rich countries in Eastern Europe to try to become members. But one should be aware that the less developed a country the longer the interim process of negotiations. Some CEECs have already managed to become members of the rich-men's club OECD - Czech Republic and soon Hungary. Others have applied (Poland and Slovenia). These are good signs. Parallel to the economic integration into the EU, the CEECs seek membership in NATO. What will be easier depends on many things, in case of NATO also on world political constellations, in case of EU membership only on the own effort and achievements to push the economy towards a functioning market economy. EU enlargement has not only an economic dimension. It would be the first time in history to unite Europe in peace. This aspect alone may be worth the costs of enlargement.

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