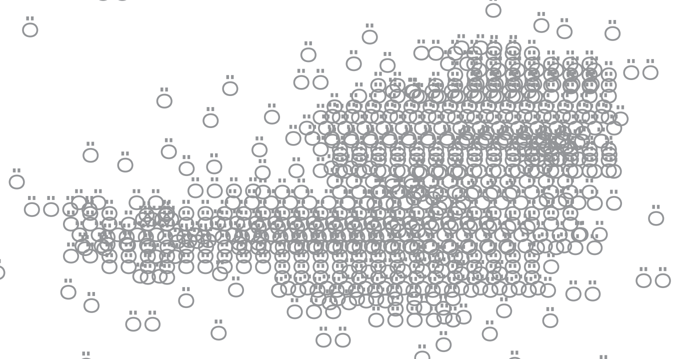
Austria's External Economic Relations 2008



Centre of Excellence
International Economics

Publisher

FIW Centre of Excellence "Research Centre International Economics"*)

c/o Austrian Institute of Economic Research, P.O. Box 91, 1103 Vienna

FIW Project Managers: Professor Fritz Breuss (WIFO)
Professor Michael Landesmann (wiiw)

Project coordination: Irene Langer (WIFO)
Susanne Sieber (WIFO)
Roman Stöllinger (wiiw)

Authors: Vasily Astrov (wiiw)
Éva Dessewffy (AK Wien)
Stefan Ederer (WIFO)
Catherine Keppel (WIFO)
Ralf Kronberger (WKO)
Michael Landesmann (wiiw)
Zdenek Lukas (wiiw)
Ina Matt (WIFO)
Harald Past (WKO)
Olga Pindyuk (wiiw)
Josef Pöschl (wiiw)
Susanne Sieber (WIFO)
Egon Smeral (WIFO)
Roman Stöllinger (wiiw)
Waltraut Urban (wiiw)
Petra Vujakovic (WIFO)

Statistical assistance: Barbara Apian-Bennewitz (wiiw)
Boriana Assenova (wiiw)
Sabine Fragner (WIFO)
Irene Langer (WIFO)
Beate Muck (wiiw)
Martha Steiner (WIFO)
Gabriele Wellan (WIFO)

Layout: Ilse Schulz (WIFO)
Marianne Uitz (WIFO)
Tatjana Weber (WIFO)

Cover design: Martina Frisch
Galgenbühelweg 13, 6020 Innsbruck

Printed by: Druckerei Ueberreuter Print und Digimedia Gmbh
Industriestraße 1, 2100 Korneuburg

All articles reflect the personal opinion of the authors. Editorial deadline for chapters 4, 6, 11 and 12 was 17 October 2008, for chapters 2, 3, 5, 7, 9 and 10 7 November 2008, and for chapters 1 and 8 17 November 2008.

*) Initiated by the Austrian Federal Ministry of Economics and Labour, as a part of the "go international" initiative.

Contents

Global Economy

1. Developments in the world economy in the context of the financial crisis

Michael Landesmann (wiiw), Roman Stöllinger (wiiw)

1.1 Introduction

The financial crisis that erupted in August 2007 shows all signs of a systemic banking crisis: the number of defaults in the banking and corporate sector have increased, asset prices have declined, depressing the capitalisation of banks, and credit mechanisms have worsened substantially.

The burst of the US sub-prime bubble made the highly leveraged and structured finance products that were used to finance mortgage loans unmarketable. The resulting fall in prices of these financial instruments led to substantial write-downs in major US banks and many of their European counterparts. Reported losses mounted to US$ 760 billion up to the end of the third quarter of 2008 and caused the demise of an entire business model, that of the US investment banks. As the crisis intensified in the course of the first half of 2008, the US government stepped in with a massive rescue package for the US banking sector. It soon became clear that some major European banks were also at the brink of insolvency, and the governments of the United Kingdom and the euro area followed suit with their own rescue plans. The rescue plans included measures to raise confidence, such as the guarantee on deposits, the purchase of illiquid assets, guarantees for new bank liabilities, injections of public capital and outright nationalisation of banks.

1.2 Uncertainty, illiquidity and de-leveraging

From the outset, major European banks shared losses that emanated from the sub-prime crisis besetting US banks. Together these banks determine the conditions on the interbank market and ensure its functioning. Major write-downs and uncertainty about future losses raised counterparty risk and increased financing costs for banks. This led to the drying up of the interbank market as banks abstained from lending to each other.

As a reaction to scarce liquidity in the interbank market, banks reduced sharply credit supply and raised interest rates on loans still granted to households and firms. The situation was aggravated by a severe de-leveraging process. Large losses in combination with excessively high leverage forced banks and financial investors to shorten their balance sheets. This, in turn, triggered the set-in of the financial accelerator, as the sale of assets by banks further depressed asset prices, including bank shares. Given the high degree of internationalisation of financial markets, the financial accelerator operated at the global level and this at least partly explains the severe drop in stock markets around the world.

1.3 Global transmission channels

The turbulences on the financial markets, with their growing insecurity, the breakdown of traditional credit mechanisms and strongly felt credit constraints, initiated an economic slump in the USA and the euro area that developed further into a recession in all major industrialised countries. There are a number of channels through which emerging markets and Central and Eastern European countries (CEEC) are being significantly affected in their own developments: One of the big success stories of a significant number of emerging markets, including many of the CEEC, was their export performance, and as economic activity in the advanced economies declines, so will their export prospects. Some emerging markets in Asia, given growing intra-Asian trade integration over the past years, might be less coupled to the business cycle in industrialised countries than in the past. Countries with a very strong export focus on the USA (e.g., Mexico) or the euro area (such as the CEEC), however, will be hit hard by diminished foreign demand.

The primary transmission channels of the crisis, however, are international financial flows and international banks. This is of particular concern for the CEEC, as most of them run large current account deficits. Many of them have been receivers of important foreign direct investment inflows in the past and, with respect to external stability, a large share of foreign direct investments (FDI) in capital inflows could be seen as an advantage. The reason is that FDI flows are less volatile than portfolio investment or direct credits to the private sector. Hence, it is often argued that countries that are able to cover their current account deficit to a very high degree by FDI, as is the case in several CEEC, are less likely to suffer a complete loss of external finance in times of crisis.

Moreover, foreign banks, predominantly from the euro area, own a large share of banking assets in many CEEC, giving them a crucial role in the domestic credit supply in those markets. However, in the current international financial crisis, foreign ownership of the banking sector might be a mixed blessing. The reason is that with a banking system that is dominated by affiliates of foreign banks, the domestic credit supply strongly depends on the funding of these affiliates by their parent banks. As major European banks suffered heavy losses and are also highly leveraged, they find it difficult to continue to supply the volume of loans to their foreign subsidiaries or they choose not to do so. In this case the domestic credit supply will decline by more than would have been the case anyway due to the tight liquidity situation in the interbank market (cross-country loans are very volatile as well). CEEC may derive some comfort from the fact that the banks (Austrian, Swedish and Italian banks) most active in the CEEC were not among those that were most severely hit by the financial crisis.

1.4 External imbalance of the US economy

The recession in the US economy that followed the financial crisis is also expected to affect the substantial external imbalances that had built up, especially in the USA and China before the crisis. The current account imbalances were the result of different saving attitudes in the consumer-oriented USA and more thrifty Asian countries, strongly aggravated by insufficient exchange rate alignments. Since its peak in 2006, the US current account has gradually declined following a continuous devaluation of the US dollar against the currencies of all major trading partners up to mid-2008. During this period, therefore, exchange rate developments supported the global balancing process while the rise in the oil price counteracted it. Since then, signs have been reversed: the recession in advanced economies has led to a rapid decline in the price of oil (and other commodities) and a rebound of the US dollar has taken place due to an increased international demand for US dollars. The current growth slowdown has also brought to an end excessive consumer demand in the USA and has induced China to move towards a somewhat less export-oriented growth process; the sustained growth differential between the USA and China, together with a longer-term appreciation of the Chinese currency, should ensure the continuation of the global equilibration process at an accelerated pace.

1.5 Unequal growth processes in a period of decelerating global growth

The global financial markets crisis is taking place in the midst of changes in the weights of different economies and regions in the global economy. Since the 1980s, the strong forces of globalisation have led important new players to have a significant impact upon global economic developments. In particular, some population-rich and land-rich economies have caught the attention of observers and been grouped together as the BRIC (Brazil, Russia, India, China). Although other emerging market economies have also made important entries into global trade relationships (e.g., other countries in South-East Asia) and the BRIC, as a group, are very heterogeneous amongst themselves, they typify how the recent crisis has affected a range of economies outside the advanced, high-income economies. Brazil and Russia are important suppliers of energy and raw materials and their export earnings have followed the dramatic upswings and downswings in oil and commodity prices over the recent period. As a result, their very large trade surpluses may be followed by a period in which the growth processes are severely interrupted and the financial systems show clear signs of fragility. China and India, on the other hand, are on a more robust growth trajectory (given that their production and export structures are much more diversified) but there, too, the dependency upon international trade links and the vulnerability of banking systems to international financial market developments have emerged clearly in the current crisis. Here we are (still) witnessing an asymmetric relationship at work, in which emerging market economies are strongly affected by the business cycle and financial developments in the high-income economies, especially in a downturn. At this stage, the weights of the emerging markets in the global economy are still insufficient to act as substitute motors to avoid a serious global slowdown. However, the current crisis is likely to cause changes in development strategies (more reliance on domestic markets and intra-Asian trade in the future) as well as changes in financial market regulation and in the development of regionalist monetary and financial arrangements which, together with continued uneven growth processes, will, over time, reduce the asymmetry which still characterises the global business cycle transmission mechanisms in the current crisis.

2. Global economic and institutional environment

Roman Stöllinger (wiiw)

2.1 The world economy at a glance

By the end of 2007, the global business cycle had passed its peak. With a GDP growth rate of 3.7 percent in that year, the world economy almost matched its 2006 performance. However, with the financial market crisis putting a strain on the US economy and the euro area, in 2008 neither of them will be able to achieve growth rates similar to those in 2007; in fact, there is an immanent risk of recession.

The developing countries, together with the Central and Eastern European Countries (CEEC), again displayed strong growth in 2007 with an increase to 8 percent, well above the long-term trend rate. The dynamic development of this group of countries is not just the result of the outstanding economic performance in China and India, but rather reflects high growth in all major regions, including Africa.

Influenced by the economic downturn in the industrialised countries, global growth is expected to slow down to approximately 2.6 percent in 2008. In the developing countries, growth will lose momentum, too, but the negative effects on the business cycle will be less pronounced and several countries will manage to maintain high growth in 2008.

On a global scale, three major factors will determine the development of the global economy. One of them is the financial market and banking crisis, whose negative impacts on the real economy began to be visible by the end of 2007. It remains to be seen whether the support measures taken by the US government and the euro area, including their central banks, will manage to restore confidence in the financial system and ward off a global recession.

The second factor is the surge in inflation, which affects the industrialised world and developing countries alike. While the industrialised countries are confronted with rising prices in times of an economic downswing, both the levels and the increases in consumer prices are much higher in developing countries. The most highly affected regions include the Middle East and the CIS.

The main drivers behind the recent rise in inflation rates are the hikes in the prices of energy, metals and food, which represent the third risk factor for the world economy. The drastic increase in the price of oil can be attributed primarily to scarce supply and subsequent speculation. Other factors include the depreciation of the US dollar, which accelerated the upward trend in oil markets since prices are denominated in US dollars. Food prices accelerated in 2007 as a result of continuously strong demand from the emerging markets, although the increase in the demand for food caused by biofuels production has also contributed to the upward trend, as have moderate harvests on the supply side.

2.2 Economic outlook for industrialised countries, the CEEC and emerging markets

The financial market and banking crisis will cause huge losses not only to banks but also in terms of output growth. Growth in 2008 is expected to fall to 1.3 percent in the **euro area** and 1 percent in the **United Kingdom**, whereas the **USA** might fare slightly better with GDP growth in the range of 1.7 percent. In **Japan,** which at first had appeared less affected by the crisis, growth is expected to decline to 0.5 percent in 2008. In 2009 all major industrialised countries will find themselves in recession simultaneously which constitutes a novelty in the post-World War II period.

An economic downturn is also observable in the **CEEC,** in most countries due to domestic factors. Since October 2008, however, the negative impacts of the liquidity crisis have also become an issue in CEEC. Several countries may be negatively affected by the weak growth performance in the euro area – the primary export destination for CEEC. High inflation is a matter of concern in many Eastern and South Eastern European countries, although this may turn out to be a short term phenomenon. **Russia** is expected to keep on growing at approximately 7 percent in 2008, supported by high commodity prices and resulting terms-of-trade gains during the first half of the year. Double-digit inflation with a strong upward trend remains a matter of concern.

Several emerging markets, including **China** and **India**, will be able to maintain high growth in 2008; for the two economies mentioned it is expected to be in the order of 10 percent and 8 percent respectively. The inflow of foreign direct investments (FDI) is expected to continue and perhaps even increase in countries like **Brazil**, which was upgraded to an investment grade credit rating in the first half of 2008. Growth prospects are somewhat less positive for **Turkey**, which is also struggling with internal political tensions, and **Mexico**, due to its economy's heavy dependence on exports to the USA. In 2009 the recession in industrialised countries will also slow down growth in all major emerging markets.

2.3 Institutional environment and trade relations

In July 2008, the **WTO** had to register a further setback in multilateral trade negotiations as the Doha Round failed over a disagreement between the USA and India on the use of the new special safeguard measures (SSM) in agriculture. The SSM would have enabled developing countries to impose or raise tariffs in the case of rapidly increasing imports or a severe decline in the import price of a certain good.

Different views prevail concerning the reasons for the collapse of the negotiations, which centred on the reduction of tariffs and subsidies in agriculture and market access in the Non-Agriculture Market Access (NAMA) area, as well as concerning the consequences for WTO members. Whereas it is difficult to judge whether the failure to conclude the Doha Round constitutes a serious loss, it seems quite obvious that in the absence of any liberalisation steps on a multilateral level, trading nations will pursue and intensify their bilateral negotiation efforts. The result will be an uncontrolled growth of bilateral trade treaties and a world trading system resembling a spaghetti bowl, causing all sorts of trade diversions.

Trade relations of the EU. The EU's new trade policy strategy adopted in 2006 calls for the expansion of bilateral free trade agreements (FTAs). In its attempt to strengthen bilateral trade relations, the EU is focusing on Asia, with FTAs under negotiation with India, South Korea and ASEAN. These FTAs have a much broader coverage of issues than multilateral negotiations, including, for example, trade in services and rules on foreign direct investment. The greatest challenge ahead lies in trade relations with China and the attempts to conclude a far-reaching Partnership and Cooperation Agreement which deals with delicate issues such as market access or the protection of intellectual property rights.

The EU is also continuing its trade negotiations with partners in Latin America, notably MERCOSUR, the GCC, and the AKP countries; however, it is possible that less progress will be achieved there. With the Euro-Mediterranean Partnership (EUROMED), the EU is striving for another Free Trade Area which is to be completed by 2010. In July 2008, a Union for the Mediterranean was founded in order to foster and broaden cooperation within the region.

Trade relations of the USA. As of September 2008, the USA have 14 FTAs in place, and further agreements with South Korea, Colombia, Panama, Oman and Peru are awaiting implementation. US trade negotiations generally follow a specific pattern: after offering bilateral elimination of tariffs for industrial goods, the USA demand unilateral access to the trading partners' market in service sectors such as banking, insurance or telecommunication. In negotiations with South Korea, this strategy touched on its limits, but the deal was finally signed, and negotiations with Malaysia and Thailand are underway.

Economic integration in Asia[1]. In November 2007, ASEAN adopted a charter which seeks to codify its rules for the first time. Among other things, the ASEAN Charter calls for the creation of a Single Market by 2015. In 2008, ASEAN signed the "ASEAN-Japan Comprehensive Economic Partnership Agreement" with the aim of establishing a Free Trade Area within the next 10 years, and also concluded a Free Trade Agreement with India as well as with Australia and New Zealand. ASEAN, together with China, Japan and South Korea, have agreed to set up a US$ 80 billion fund of exchange reserves to prevent a poten-

[1] The English summary of developments in Asia was provided by Waltraut Urban.

tial financial crisis from spreading in the region. The Asia-Pacific Economic Cooperation (APEC) – a forum for 21 countries including the USA that has not played a significant role in Asian regional cooperation so far – confirmed its positive stance on the free trade system, particularly in the face of the current global financial crisis, on its 2008 Summit in Lima (Peru). In Central Asia, the settlement of the border conflict between Kazakhstan and Kyrgyzstan has paved the way for deeper economic cooperation.

Economic integration in South America. With MERCOSUR and the Andean Community South America, two regional customs unions exist which both remain incomplete. Both trade blocks are struggling with internal differences, and the lack of supranational institutions makes further progress in the integration process difficult. With the exit of Venezuela in 2006, the Andean Community lost an important member, which in the same year joined MERCOSUR but with its formal membership still awaiting ratification.

In the **Aid for Trade Initiative**, greater willingness among donor countries to augment amounts of aid led to an increase in aid for trade flows reaching US$ 24 billion in 2006. Most aid for trade was dedicated to economic infrastructure and productive capacity building. The main recipient countries were Iraq, India, Vietnam, Afghanistan and Indonesia.

3. Developments in world trade

Roman Stöllinger (wiiw)

3.1 General developments

Trade in goods and services as well as foreign direct investment (FDI) flows kept on growing much faster than world output in 2007, although real growth lost momentum in comparison to the preceding year. In real terms, trade in goods and services grew by 7.1 percent, less than half of nominal growth in US dollars.

Total exports and FDI flows amounted to almost US$ 19,000 billion, with trade in goods accounting for the major portion of the flows (US$ 14,000 billion).

3.2 International trade in goods

Developments in international trade in goods were marked by large changes in relative prices which – against the long-term trend – have moved in favour of oil, ores, metals and food since 2002. These implied large terms-of-trade gains for resource-rich regions, especially the Middle East and Africa, but also countries from the Commonwealth of Independent States (CIS) and Latin America. Low elasticity of demand for resources translated these price changes into increased export revenues for exporters of primary goods. None of the resource-rich regions, however, experienced an improvement in their current account in 2007 because, due to soaring import demand growth, import growth exceeded export growth by a large extent.

Due to the economic downturn provoked by the financial market crisis in the USA, real import demand growth came close to a standstill in 2007. In the EU-27, both exports and imports expanded only moderately; however, in 2007 growth rates in the 12 new member states were still much higher than in the other member states.

The increase in the relative prices of primary goods also raised the share of fuels, ores and metals in total world trade over the last ten years. Nevertheless, world trade remains dominated by trade in machinery and transport equipment and other manufactures, which together account for 60 percent of global trade flows. Examining trade in more detailed product groups reveals that passenger cars and oil remain the most important traded goods, but also that growth over the last 5 years was highest in a large number of metals and ores, especially nickel. This contrasts sharply with the situation in 1980 to 1998 when relatively technology-intensive products like transistors and semiconductors, computers and office equipment, and cosmetics were the most dynamic products. The situation in the period 2002 to 2007 also differed because trade expansion was primarily driven by price effects and less so by an increase in volumes.

The broad picture of world trade changed only marginally in 2007, with a large part of trade flows being intra-regional trade between the major trading hubs, the EU-27, NAFTA and the Asian region. "Internal exports", i.e., exports between EU member countries, make up for about one quarter of world trade. EU, NAFTA and Asia also account for the majority of inter-regional trade flows.

The fragmentation of the production process for complex manufactures, which involves the location of labour-intensive steps of production in low-wage countries, is one of the driving forces behind the rise of China and South-East Asian countries as major trading nations. The fragmentation of production, reflected in the trade in "parts and components", constitutes a type of intra-industry trade that further favours intra-regional trade, as the outsourcing of parts of production predominantly takes place within the major regional trade blocs, EU and NAFTA, as well as the Asian region, including ASEAN, China and Japan.

3.3 International trade in services

International trade in services grew by 18 percent in 2007, with strongest growth in the broad category of "other sectors", which includes all commercial services apart from transport and travel. This reflects a long-term trend that reduced the share of the two traditional service sectors, transport and travel, to below 50 percent of total trade in services in 2007.

Services trade is even more concentrated in the major trading hubs than goods trade, with more than half of global exports of services originating from the EU. The share attributable to the USA was 16 percent in 2007. The USA remained the single most important service exporter, followed by the large EU economies, United Kingdom, Germany, France, Spain, and Japan. China accounts for 4 percent of total services exports, less than half of the share it occupies in goods trade. The under-representation of developing countries in services trade reflects the smaller share of services in output that in the end is the result of lower per capita income in developing countries. The exception in this respect is India, which ranked ninth in the list of global services and specialises more in the export of services than in the export of goods.

In the EU, the services sectors that grew most strongly over the last ten years were computer and information services, communication and financial services. In the USA, exports of insurance services expanded most. These sectors were also the fastest-growing sectors worldwide. Trade in patents and licensing fees also expanded, with very high import growth in the new EU member states, Russia and emerging markets, which is a concomitant feature of a catch-up process that is supported by the import of foreign technology. Financial services and patents and licensing fees are the most important services sectors apart from transport and travel, accounting for 5 percent and 4.5 percent of total services exports respectively.

3.4 Global foreign direct investment

Global foreign direct investment (FDI) flows rose by 30 percent in 2007 to a record level of US$ 1,800 billion. This reflects the healthy state of the economy until mid-2007 and high company profits. In addition, attempts by governments to attract FDI have also contributed to the upward trend of the last 4 years, evidencing a favourable investment climate. Despite the undoubtedly positive long-term trend in global FDI, growth rates of FDI flows in 2007 measured in US dollars are inflated by exchange rate developments, more precisely by the appreciation of the euro and other major European currencies against the US dollar.

With regard to the sectoral composition of FDI, the most striking feature is that when compared to trade flows, the roles of manufacturing and the services sector are inversed: with almost 60 percent of total FDI flows, the services sector is more important than the manufacturing sector, which contributes roughly 35 percent. Among the services sectors, finance stands out at the single most important sector in terms of FDI stocks, owing to the liberalisation of the financial sector and the following internationalisation of banks. In the light of the current financial crisis, however, it is very unlikely that the upward trend in FDI in financial services will continue in 2008.

Looking at the regional dimension of FDI, three major trends are discernible: First of all, the rise in FDI flows comprises all major regions of the world. In resource-rich regions, including many developing countries, high prices of commodities have attracted FDI due to increased profit opportunities, whereas high company profits in Europe and the USA have boosted M&A there. In the EU, the deepening of integration in the Single Market also contributed to the surge in active FDI flows in 2007 as did investment opportunities in the USA, where the low US dollar meant that US companies were relatively inexpensive to acquire. In Asia, the potential – i.e., size and growth – of the Chinese and Indian markets continued to attract high volumes of FDI, and regional integration among ASEAN countries also helped intra-regional FDI flows to expand. China and India as well as Malaysia and Singapore became major investors in Asia but also in Africa and South America. In China a part of the FDI is undertaken, directly or indirectly, by Sovereign Wealth Funds (SWFs), whose investment decisions are also guided by strategic considerations. As in the countries of the Gulf region, home to the largest SWFs, these investment funds predominantly engage in portfolio investments. With estimated total assets of US$ 5,000 billion, SFWs, however, have a large potential to become major investors in FDI. Secondly, despite the global upwards trends, FDI flows have remained strongly concentrated in the major industrial countries, notably the USA and the EU. Together they accounted for three quarters of global outward FDI but were also host to more than 60 percent of global inward flows. Related to this is the third point, namely that both the USA and the EU are net capital exporters with respect to FDI. This is not surprising, given that most of the largest multinational firms are domiciled there, but considering the current account deficits of the USA and some major EU countries, such as the United Kingdom or France, this cannot be taken for granted.

Austria's External Economic Relations

4. Economic development, price competitiveness and an overview of Austria's external economic relations

4.1 Economic development (including outlook for 2008 and 2009)

Stefan Ederer (WIFO)

The Austrian economy grew in the year 2007 almost to the same extent as in the year before (+3.1 percent). The upswing, which had begun in 2004, was prolonged. Its growth impulses mainly arose from abroad. The high growth of the global economy induced an increase in export demand, a favourable trend which also highly stimulated investment expenditures, especially investment in machinery and equipment. Construction investment lost momentum during the year and showed only average growth. In contrast, no stimulation of private consumption expenditures was observed. This was mainly due to the persistently sluggish expansion of incomes. The high and lasting growth rates produced an improvement of the situation in the labour market; the number of actively employed persons increased remarkably on an annual average and the unemployment rate dropped. The inflation rate rose over the course of the year, mainly as a result of high global increases in energy and food prices from mid-year onward.

The upswing continued into 2008; however, the growth rates decreased considerably in the course of the year. The financial crisis and the consequent slowdown of the global economy even provoked a temporary decline of GDP. For 2008, a growth rate of 2 percent is expected. The weakening international economic activity dampened the Austrian export sector. Additionally, exports have been suffering from a disadvantageous exchange rate with respect to the US dollar. It is therefore anticipated that the growth rate of exports will be cut in half. The sluggish economic situation has also induced a slowdown of investment demand. Investments in machinery and equipment are reacting strongly to the economic slowdown. In the construction sector, however, growth will slacken only slightly. With high inflation reducing the purchasing power of private households, private consumption expenditures will once again be unable to stabilise economic activity in 2008. The trend reversal can already be observed in the labour market, although on an annual average employment is still rising. The inflation rate is expected to gradually fall until the end of the year, but will nevertheless remain considerably above the level of the year before.

In the first half of the year 2009, the slack economic situation will be prolonged. Only in the second half of the year could the economy possibly recover in line with international economic activity. On an annual average, GDP will rise by only 0.9 percent. The increasingly sluggish expansion of the world economy will dampen export demand. Moreover, investment will be affected intensely. Investment in machinery and equipment – corresponding to the typical evolvement of the business cycle – will even decline, and the growth of construction investment will be reduced. Private consumption expenditures in 2009 are expected to increase approximately to the same extent as in 2008. Without any impulses from abroad and in light of the sluggish expansion of aggregate demand, consumption expenditures will even stabilise the business cycle. In the labour market, the slackening economic activity will have a negative impact, so that the number of employed persons will grow only slightly and the unemployment rate will rise again. Inflation will be reduced considerably. In addition to the slowdown in the increase of energy and food prices, the reduction of value added tax on medicaments and the abolition of student fees recently decided by the Austrian parliament will dampen inflation. The latest events associated with the financial crisis, however, cannot be evaluated yet and are not accounted for in the current forecast. The results, therefore, are extremely uncertain.

4.2 Price competitiveness

Susanne Sieber (WIFO)

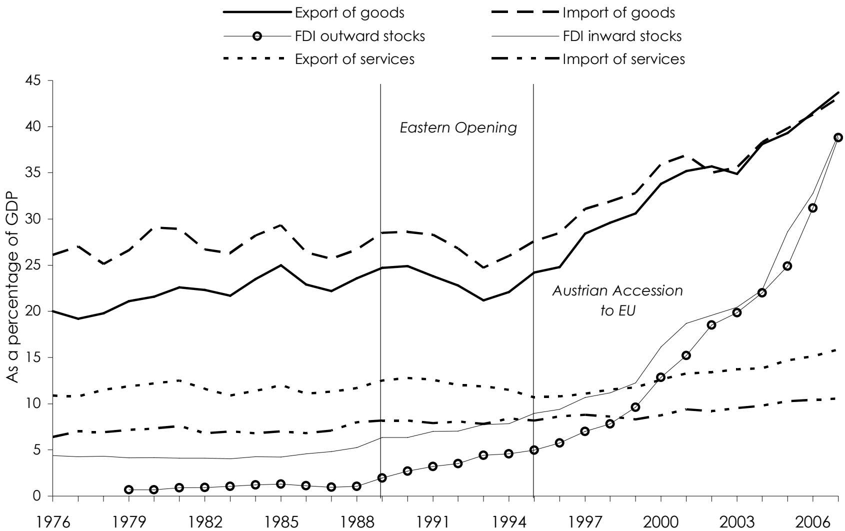
The indicators of price competitiveness in manufacturing showed a slightly deterioration in 2007; the unit labour costs relative to the trade partners increased by 1 percent. In the export boom year 2006 the decrease of the relative unit labour costs (–2.9 percent) had still reflected an improvement in international price competitiveness. With respect to Germany, Austrian manufacturing unit labour costs even went down by 2.5 percent in 2007. Also, the unit labour costs for the total economy showed a slightly deterioration of Austria's international price competitiveness. Probably due to the weak US dollar, exports to the USA, especially, were dampened; the real effective exchange rate increased in 2007.

4.3 Overview of Austria's external economic relations – trade in goods, services and foreign direct investment

Susanne Sieber (WIFO)

4.3.1 Austrian integration in the world economy

Figure 4.1: Development of Austrian export, import and foreign investment quotas



Source: Statistics Austria, OeNB, WIFO calculations. Exports respective imports of goods or services according to national accounts.

Austria's increasing globalisation is reflected in the dynamic development of foreign direct investment stocks and trade of goods. The increase of their quotas (as a percentage of GDP) in 2007 and the years before are displayed in Figure 4.1. The share of trade in services in GDP also increased again in 2007, even if not as remarkably as Austrian direct investment stocks abroad. The quota of Austria's investments abroad increased by 7.6 percentage points in 2007.

4.3.2 Trade in the national accounts

Real net exports of goods and services provided an important contribution to economic growth in 2007. Austrian trade can therefore be cited again as an important engine for total economic growth.

Taking the exports of goods and services together, this export quota already amounts to 60 percent of Austrian GDP. The main part of total trade – namely about three quarters – can be attributed to trade in goods.

In 2007, as in the years before, the balance of trade in services showed a high surplus; since 2006 the balance of trade in goods has, according to the national accounts, also reported a surplus.

5. Austrian trade in goods

Susanne Sieber (WIFO)

5.1 Development in 2007

Table 5.1: Overview of Austrian trade in goods

	2005	2006	2007	2008[1])	2008 First half year
Exports			Billion €		
Values	94.7	103.7	114.7	120.9	60.3
			Annual percentage changes		
Values	+ 5.4	+ 9.5	+ 10.5	+ 5.5	+ 6.1
Real	+ 3.2	+ 6.8	+ 8.7	+ 4.1	.
Prices	+ 2.1	+ 2.6	+ 1.7	+ 1.3	.
Imports			Billion €		
Values	96.5	104.2	114.3	121.3	59.8
			Annual percentage changes		
Values	+ 5.9	+ 8.0	+ 9.6	+ 6.2	+ 7.0
Real	+ 3.0	+ 4.1	+ 7.9	+ 3.8	.
Prices	+ 2.9	+ 3.7	+ 1.6	+ 2.3	.
Balance			Billion €		
Values	– 1.8	– 0.5	0.4	– 0.4	0.5
Change	– 0.6	+ 1.3	+ 0.9	– 0.8	– 0.4
			Annual percentage changes		
Terms of Trade	– 0.8	– 1.1	+ 0.1	– 1.0	.

Source: Statistics Austria, WIFO calculations. – [1]) WIFO Forecast October 2008.

In 2007 Austria still benefited from the favourable international situation. Austrian nominal exports increased by 10.5 percent compared to the previous year; in total, goods with a value of € 114.7 billion were exported. Austrian nominal imports also developed dynamically (+9.6 percent). For the second time since World War II, the Austrian trade balance achieved a positive value. The Terms of Trade improved slightly in 2007.

Austrian exports to Germany – Austria's most important trading partner – again provided the highest contribution to export growth in 2007, with clearly significant contributions also coming from trade with Central and Eastern European countries (CEEC).

5.2 Regional structure in 2007

Overall, Austria's exports still go mainly to EU member states. 72.5 percent of all exports went to the EU-27 in 2007, although over the last years a shifting of shares within these EU trade partners has been visible. Whereas the share of exports to the EU-15 member states decreased to 55.9 percent in 2007, the share of exports to the EU-12 member states clearly increased, climbing to 16.5 percent in 2007. Besides the EU, the EFTA (especially Switzerland), NAFTA (especially the USA) and the remaining CEEC, which are not members of the EU, are additional important destinations for Austrian goods.

In 2007, exports to the five neighbouring CEEC showed extraordinary expansion, with exports to Slovenia increasing by 26.9 percent, to Poland by 25.9 percent, to the Czech Republic by 20.8 percent, to Slovakia by 16.3 percent and to Hungary by 14.2 percent. Exports to the two new member states Romania and Bulgaria, which joined the EU in 2007, also developed very dynamically in 2007 (+17.6 percent and +29.9 percent, respectively).

5.3 Sectoral structure in 2007

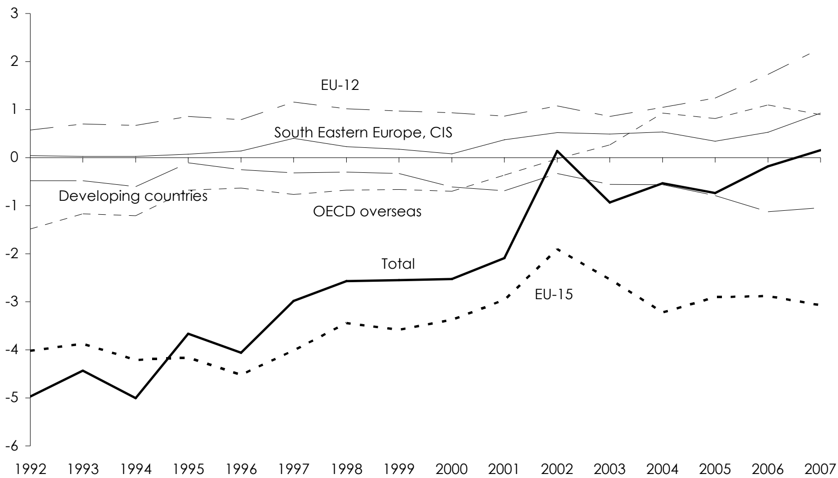
Exports of final goods is still by far the most important broad category in Austrian trade, constituting a share of 72 percent. Within this group, more than one third of the exported goods are investment goods; the rest are consumer goods. In 2007, exports of intermediate products comprised a share of 15.8 percent, while the shares of exports of raw materials and energy and exports of food were clearly smaller, at 6.3 percent and 5.9 percent respectively.

The ongoing price increases in raw materials, especially oil, although less dramatic than in the year before, resulted in a slight increase in the value of oil imports, despite the fact that the quantity imported decreased. However, the value of all fuel and energy imports taken together decreased in 2007.

5.4 Trade balance development as of 2007, including regional and sectoral structures

As already mentioned, the trade balance was positive in 2007 for the second time since World War II. Since the Austrian trade balance has shown a clear trend toward improvement over the last years, this remarkable result is not so surprising. Significant positive contributions to this improvement have come from trade with South Eastern Europe, CIS Europe and OECD overseas countries.

Figure 5.1: Austrian trade balance as a percentage of GDP



Source: Statistics Austria, WIFO calculations.

6. Austrian trade in services

Ina Matt (WIFO)

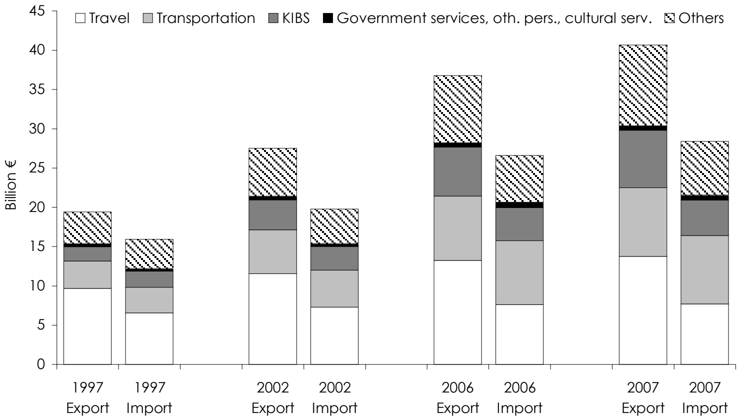
6.1 Development of trade in services in the last decade

Trade in services accounts for 60 percent to 80 percent of value added but only 20 percent of trade world wide. In the last decade, trade in services grew proportionally to trade in goods. In the smaller EU countries, trade in services is more important than in the larger ones. In Austria's trade in services in 2007, exports amounted to € 40.7 billion and imports came to € 28.4 billion. Exports and imports grew with a compound annual growth rate of 8 percent and 6 percent respectively. The weight of the services balance in the balance of payments has diminished since the new compilation practice for the balance of payments came into force. Looking at the new balance of payments, the general trend of the activation of trade in services appears the same, but begins at an earlier point in time.

6.2 Development of the structure of services in main categories

The most important category is travel, with an export value of € 13.8 billion in 2007, or 34 percent of all services exports. In 1997 travel still accounted for 50 percent of all services exports. The export of transport services developed dynamically and was the second biggest group in 2007. In the last decade, a structural shift took place from travel towards transportation, other services and knowledge-intensive business services (KIBS).

Figure 6.1: Development of the structure of services exports and imports, 1997 to 2007



Source: OeNB.

6.3 Detailed structure of services exports in 2007

The EU-15 represents Austria's main trading partner with respect to travel services. 74 percent of all exports were in the region and 57 percent of all imports of travel services came from the EU-15 in 2007. The freight transports category accounts for 70 percent of all exports in transportation services. In 2007 its export value was € 5.9 billion. Since

Austria's accession to the EU in 1995, but especially since the end of the 1990s, Austria's freight transport exports have more than doubled. The largest other categories are the category of merchanting and other trade-related services and the category of architectural, engineering and other technical consultancy, each with an export value of € 2.5 billion in 2007. Insurance services are still € 345 million in deficit.

6.4 Focus: knowledge-intensive business services (KIBS)

The importance of services goes beyond their direct contribution to production and growth. Services are important input factors in a broad area of economic sectors and their efficiency as well as their technological and innovative orientation determine the competitiveness of the economy. KIBS are especially important in this context as producers of new knowledge, as knowledge diffusers and, last but not least, because of their huge market potential. In Austria, the export of KIBS grew from 9 percent of all services exports in 1997 to 18 percent in 2007.

Architectural, engineering and other technical consultancy accounts for 35 percent of all exports in KIBS. R&D was the second biggest sector in KIBS with an export value of € 1.6 billion. The highest growth rate in KIBS was achieved by computer and information services, with a compound annual growth rate in the last 10 years of 25 percent. The smallest sector in exports is royalties and license fees, which accounts for only 8 percent in exports but almost 25 percent in imports of KIBS. The deficit in this sector is especially relevant because it can be drawn on as an approximation for technological progress.

6.5 Regional structure of services trade

75 percent of the Austrian services trade takes place within the EU-27. In 2007, € 25 billion (or 62 percent of all services exports) went to the EU-15, but only 57 percent of all services imports came from the EU-15. 13 percent of all services exports worldwide went to the EU-12 and 17 percent of all imports came from the same group of countries. The most important trading partner is Germany, with an export value of € 15 billion. In a regional comparison between the EU-15 and the EU-12, one can see a clear technological differentiation in trade. Within the EU-15, Austria exports mostly travel services and other business services and imports other business services. In 2007, 16 percent of all exports to EU-15 member states were KIBS; the biggest sectors, here again, were architectural, engineering and other technical consultancy, R&D, and computer and information services. On the import side, KIBS accounted for almost one fifth of services from the EU-15.

To the EU-12, Austria exported mostly other producer-related services (€ 1.7 billion), with merchanting and other trade-related services accounting for € 0.7 billion thereof. The net account for transportation services was negative; these accounted for almost 40 percent of all Austrian imports from the EU-12. In contrast to the EU-15, the net account for R&D with the EU-12 member states was also negative. The largest position of KIBS was again architectural, engineering and other technical consultancy, with an export value of € 300 million.

6.6 Tourism

Egon Smeral (WIFO)

Austria recorded 20.77 million foreign guests arriving in 2007, a plus of 2.5 percent over the previous year. According to the balance of payments, revenues from international tourism (tourism exports including international passenger transport) amounted to € 15.63 billion (an increase of 3.2 percent or 0.6 percent in real terms).

In spite of the lack of snow during the 2006/07 winter season, Austria managed to maintain its market share of international European tourism – in terms of tourism exports based on US dollars – as an average across 2007, due to a good summer season. At 4.7 percent, the figure exceeded the historic low of 2000 (4.6 percent).

The biggest winners of market share in 2007 were Poland, Sweden, France, Portugal and the Netherlands. Of the major European tourist destinations, Germany, Italy, Turkey, Greece and Spain suffered most.

At a growth of 2 percent, Austria managed a slight increase in revenues during the 2006/07 winter season, in spite of the serious shortage of snow, with spending by domestic guests rising faster (+3.1 percent) than that of foreigners (+1.7 percent).

In the 2007 summer season, the Austrian tourism industry achieved a noticeable increase in revenues of 4 percent overall (+1.3 percent in real terms), where receipts from domestic guests (+4.6 percent) were more dynamic than those from foreign guests (+3.7 percent). Counter to the previous trend, demand for overnight stays in the summer season of 2007 grew notably less strongly in the cities (+1.4 percent) than in the rest of Austria (+3.6 percent).

In the 2007/08 winter season the previous year's revenue level could be significantly exceeded (+6.6 percent), which resulted in revenues of slightly over € 12 billion.

In the summer season of 2008, Austria's tourism industry continued its successful course of the previous winter season. According to preliminary calculations, revenues increased by 6.6 percent to reach a volume of € 7.61 billion in May to August 2008. In real terms (after reducing figures by the inflation rate) revenues rose by 2.8 percent against the relatively high level of the previous year (+2.6 percent in real terms). With this, Austria's tourism industry is set on a growth course that promises to get back its market share.

7. Austrian foreign direct investment

Catherine Keppel (WIFO), Susanne Sieber (WIFO)

7.1 Austria's position in international comparison

Table 7.1: Development of foreign direct investment, worldwide and in Austria

	Outward flows			Outward stocks		
	World	Austria	Austria	World	Austria	Austria
	Billion €		Percentage shares	Billion €		Percentage shares
1999	1,020	2.85	0.28	5,126	19.04	0.37
2000	1,333	5.98	0.45	6,607	26.67	0.40
2001	839	3.38	0.40	7,482	32.35	0.43
2002	569	6.14	1.08	7,044	40.51	0.58
2003	498	6.08	1.22	6,936	44.31	0.64
2004	740	6.47	0.87	7,488	51.25	0.68
2005	708	8.96	1.27	8,983	60.87	0.68
2006	1,054	10.90	1.03	9,686	80.26	0.83
2007	1,457	24.88	1.71	10,599	.	.
	Inward flows			Inward stocks		
	World	Austria	Austria	World	Austria	Austria
	Billion €		Percentage shares	Billion €		Percentage shares
1999	1,020	2.59	0.25	4,899	24.26	0.50
2000	1,513	9.23	0.61	6,219	33.49	0.54
2001	920	6.36	0.69	6,994	39.71	0.57
2002	662	0.15	0.02	6,446	42.81	0.66
2003	496	5.49	1.11	6,469	45.63	0.71
2004	577	2.56	0.44	7,038	51.92	0.74
2005	770	8.67	1.13	8,629	69.98	0.81
2006	1,124	6.32	0.56	9,469	84.34	0.89
2007	1,338	21.74	1.62	10,333	.	.

Source: Values for the world: UNCTAD, World Investment Report 2008; values for Austria: OeNB (update September 2008); WIFO calculations.

Austria's inward and outward foreign direct investment (FDI) represents an increasingly important part of Austria's external economic relations. On the one hand, Austrian firms have managed to foster the international presence of subsidiaries in foreign countries (outward foreign direct investment), on the other hand, Austria itself is an attractive business location for foreign investors (inward foreign direct investment). In 2007 Austria achieved new record levels in both inward and outward foreign direct investment. However, the increases in outward FDI flows in 2007 and in stocks in 2006 were driven by a couple of huge transactions in the financial sector. Especially in the inward FDI flows in 2007, which amounted to € 21.7 billion, there was an abrupt rise compared to the previous year. But also looking at outward flows, we observe a dramatic change within one year. Outward transactions in 2007 add up to € 24.9 billion.

As a measure of a country's degree of internationalisation, the ratios of Austrian outward FDI stocks to its GDP show a continuous increase over time. In 2006 the share of Austrian FDI in GDP was approximately as high as the average rate in industrialised countries. But also when looking at internationalisation in terms of inward FDI, however, Austria is still behind the average of EU-27 countries in the proportion of FDI stock – both inward and outward – to GDP.

7.2 Austrian outward foreign direct investment

In 2006, Austrian outward FDI stocks reached a level of € 80.3 billion. The regional structure of Austrian investment in foreign countries is characterised by a strong focus on Europe. The share of FDI stocks held in Europe accounts for 90.5 percent of all Austrian outward FDI stocks. Furthermore, an extraordinarily high fraction of outward FDI is undertaken in Central and Eastern Europe; the importance of this region for Austrian outward FDI has increased strongly since the Eastern Opening. In 2006, more than 45 percent of Austrian outward FDI went to this region. In contrast, only about one third of investments went to EU-15 countries.

Austria's strong position as an important investor in Central and Eastern Europe is emphasised by the market shares of Austrian FDI in the CEE region. In five countries in Central and Eastern Europe – Bosnia and Herzegovina, Croatia, Slovenia, Romania and Bulgaria – Austria is the most important investor. Austria is responsible for 8 percent of inward FDI received in the CEE-5 and 6.2 percent of that received in the CEE-19, whereas in global inward FDI Austria achieves a market share of only 0.7 percent.

Generally the main motivation for Austrian firms to invest abroad lies in market-seeking intentions; the cost criterion seems to be of less importance.

In the sectoral structure, a relative importance of the services sector over manufacturing is observable, with the former amounting to 72.6 percent of outward FDI. In general, the sectoral structure reveals a concentration on very few branches; the financial sector (27.8 percent) and the real estate sector (27.2 percent) exhibit the highest shares, followed by trade and repair (13.1 percent).

Austria's enterprises were amongst the first investors in Central and Eastern Europe. At first they suffered losses in the region, but soon afterwards they were able to profit from above-average economic growth rates and realise profits in Central and Eastern Europe.

By now, Austria's investors hold a major part of the domestic banking system in many countries of the CEE region. The performance of Austrian subsidiaries in the CEE financial sector contributed to about 38.7 percent of all Austrian banks' performance in 2006.

7.3 Austrian inward foreign direct investment

In 2006, Austrian inward FDI amounted to € 84.3 billion. A major part of investment came from European countries; more than 70 percent of this inward FDI stock originated from the EU-15. Irrespective of the decrease in the German share in Austrian inward FDI stocks in 2006, Germany still constitutes the most important investor in Austrian inward FDI stocks.

Even more than in outward FDI, the sectoral structure of Austrian inward FDI is dominated by the services sector, which accounts for 86.5 percent of total 2006 inward direct investment stocks in Austria. The main target branches are the real estate sector (42.7 percent) and, once again, the financial sector (24.7 percent) as well as trade and repair (14.3 percent).

In the rankings given by the Inward FDI Performance Index (*UNCTAD*, 2008), Austria achieved a better rating, improving by 33 positions to take position 56 in 2005 to 2007. The main improvements in the determinants relevant for investment in Austria are related to research & development and tax policy (*Bellak – Leibrecht – Stehrer*, 2008). Further criteria turn out to be the education level of workers as well as legal security (*Sieber,* 2008).

7.4 Development of employment figures of Austrian foreign direct investment

Both employment in Austrian subsidiaries in foreign countries and employment in foreign affiliates in Austria rose significantly. In 2006, 478,872 persons (weighted by share in voting capital) were employed in Austrian subsidiaries abroad and 237,368 persons worked in foreign direct investment enterprises in Austria. Hence, the number of people employed in Austrian companies abroad was about twice as high as the number of people working in foreign subsidiaries in Austria.

7.5 Profitability of Austrian foreign direct investment

Profits arising from Austrian outward foreign direct investment achieved high growth over the past years. Austrian investments abroad gained profits of € 7.5 billion in 2006. Return on equity likewise increased to 12.5 percent for Austrian outward FDI in 2006. Investment in Central and Eastern Europe is, to a high degree, responsible for the rate of return. Very high returns on equity are obtained in the CEE-19 (15.3 percent) and lower than average rates in the euro area 15 (5.8 percent). Return on Austrian inward FDI decreased in 2006 to 12.5 percent.

7.6 References

Bellak, C., "Leibrecht, M., Stehrer, R., Policies to attract Foreign Direct Investment: An industry-level analysis", FIW Research Report, 2008, (019), http://www.fiw.ac.at/fileadmin/ Documents/Publikationen/fiwstudie19.pdf.

OeNB, "Direktinvestitionen überspringen die 100-Mrd-Euro-Grenze; Ergebnisse der Direktinvestitionsbefragung 2006", Presseaussendung vom 24. September 2008, http://www.oenb.at/de/stat_melders/presse/Aussenwirtschaft/Direktinvestitionen/2008/pa_di_20080924_direktinvestitionen_uebersprinaen_die_100_mrd_euro-grenze.jsp#tcm:14-89561.

Sieber, S., Österreichs Attraktivität für ausländische Direktinvestitionen sowie als Standort für Headquarters-Funktionen, FIW Research Report, 2008, (021), http://www.fiw.ac.at/ fileadmin/Documents/Publikationen/fiwstudie21.pdf.

UNCTAD, World Investment Report 2008, Transnational Corporations, Extractive Industries and Development, UNO, New York-Geneva, 2008.

8. Austria's foreign trade specialisation, competitiveness and quality indicators

Susanne Sieber (WIFO)

8.1 Actual trends and challenges

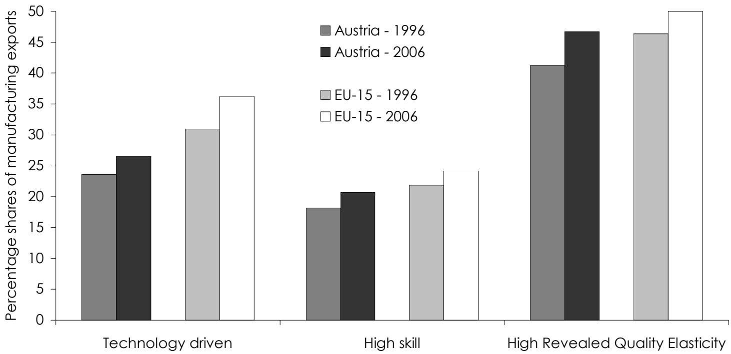
One of the most important challenges for Austria in the coming years will be the change from a middle technology position to the technological frontier. Therefore, it is important for Austria to specialise in technology-driven industries or high-quality exports.

8.2 Austria's trade performance

8.2.1 Importance of sophisticated industries in Austrian foreign trade

In order to cope with these challenges, Austria needs a structural change to more sophisticated industries. In 2006, the share of industries with intensive quality competition (or a high revealed elasticity) in total manufacturing trade was 46.7 percent. The shares of technology-driven industries and high-skill industries are even lower. In addition, all three shares are lower than the corresponding EU-15 share.

Figure 8.1: Structural change of sophisticated types of industries in Austria and in the EU-15



Source: UNO, Statistics Austria, WIFO calculations. Including intra-EU trade. Classification of industries according to *Peneder* (2001) and *Aiginger* (2000).

8.2.2 Austria's foreign trade specialisation

Austrian trade specialises mainly in mainstream industries. However, 2006 also shows a positive – although weak – tendency toward specialisation in technology-intensive industries. Considering the change in specialisation as measured by RCA values, we observe a tendency of structural changes toward a future-oriented industry structure.

8.2.3 Competitiveness of the Austrian economy

Measuring Austrian competitiveness in foreign trade on the basis of world market shares reveals that within these so-called sophisticated industries, above-average market shares were only achieved in the industries with intensive quality competition.

8.3 Quality indicators – Comparison of Austria's position with that of the EU-15 countries

The average value per kilogram of Austrian exports lies above the corresponding value of imports, signalling that more high-quality products may be exported than imported. The share of Austrian intra-industry trade (IIT) in total trade amounted to 67 percent in 2006; a major part of it is vertical IIT. The absolute share of vertical high-quality IIT in Austria – as a quality indicator – is surpassed within the EU-15 only by five other member states (United Kingdom, Luxembourg, the Netherlands, Germany and Denmark).

Table 8.1: Austrian foreign trade performance in comparison with the EU-15 and the EU-12

In 2006

	Austria			EU-15			EU-12		
	Trade balance	RCA value	Export world market share	Trade balance	RCA value	Export world market share	Trade balance	RCA value	Export world market share
	Million €		Percent	Million €		Percent	Million €		Percent
Factors of production									
Mainstream	6,661	0.246	2.00	158,758	0.259	44.99	– 11,355	– 0.151	5.20
Labour intensive	1,639	0.127	1.56	– 17,607	– 0.058	32.78	17,848	0.443	6.38
Capital intensive	– 4,298	– 0.187	1.41	– 1,191	– 0.002	39.59	– 9,932	– 0.185	3.84
Marketing driven	1,376	0.106	1.67	12,943	0.035	45.18	– 4,037	– 0.127	4.15
Technology driven	1,667	0.060	1.01	89,400	0.084	39.07	– 11,960	– 0.136	3.36
Human capital									
Low skill	1,069	0.011	1.47	– 20,635	– 0.028	38.26	– 6,866	– 0.090	4.44
Medium skill/blue c.w.	6,421	0.062	2.05	53,942	0.084	42.92	20,399	0.264	6.50
Medium skill/white c.w.	– 3,879	– 0.037	1.04	77,579	0.087	36.64	– 16,434	– 0.187	3.67
High skill	3,434	0.045	1.39	131,416	0.195	46.00	– 16,535	– 0.348	2.88
Quality competition									
Low revealed quality elasticity	2,869	0.012	1.44	– 7,349	– 0.009	37.16	1,262	0.014	4.86
Medium revealed quality elasticity	– 2,373	– 0.011	1.25	– 3,730	– 0.005	34.15	– 5,893	– 0.071	4.37
High revealed quality elasticity	6,548	0.017	1.53	253,381	0.181	46.37	– 14,805	– 0.128	3.82
Manufacturing	7,045		1.43	242,303		40.31	– 19,436		4.27

Source: UNO, Statistics Austria, WIFO calculations. Including intra-EU trade. Classification of industries according to *Peneder* (2001) and *Aiginger* (2000).

Trade-related Topics

9. Foreign trade and growth

Ralf Kronberger (The Austrian Federal Economic Chamber),
Harald Past (The Austrian Federal Economic Chamber)

Numerous econometric models pertaining to the benefits of liberalised trade have been published in recent years. Due to different methods and different assumptions, results differ substantially. Worldwide gains of up to 3 to 4 digit billion US dollar amounts can result from increased trade liberalisation and a reduction of trade barriers. Although economic growth in Austria is currently slowing down, export growth is expected to achieve a higher rate than GDP growth. The estimation of value added impacts of foreign export shows that one euro of additional exports leads to an expansion of Austrian GDP by about € 1.40; each additional million euros in export growth creates eight new jobs in Austria.

Trade policy is not as prominent in the national political debate as it could be. The reasons – among others – are the complex institutional setting of trade policy institutions and the variety of trade policy instruments. Analysis of external trade and trade policy could be extended by the recent formation of the Research Centre for International Economics, located in Vienna. As regards the assessment of the current trade policy at the WTO level, there is at present little reason for optimism, since, after seven years, the negotiation results are still poor. The large impact of the current financial crisis could have been dampened to some extent if sensible negotiation results had been achieved earlier.

10. The new trade policy of the EU

Waltraut Urban (wiiw)

In 2007, the European Commission launched negotiations for bilateral free trade agreements (FTAs) with India, the Republic of Korea and ASEAN. They are much more complex than former FTAs and are based on the EU's new trade policy framework outlined in the Commission's Report "Global Europe – Competing in the World" of October 2006. The new trade policy is intended to take account of important recent developments such as the increasing fragmentation and globalisation of production processes, the rising importance of "behind the border" barriers to trade, the growing share of trade in services and the emergence of new dynamic markets, particularly in Asia. It has three pillars: multilateral negotiations in the framework of the WTO to further liberalise international trade; bilateral free trade agreements with large, fast-growing markets showing relative high barriers to EU trade; a number of other initiatives targeting special issues which are highly important for the growth of EU trade, such as transatlantic trade and competitiveness; economic relations with China; enforcement of intellectual property rights; a renewed market access strategy; ensuring a level playing field for EU suppliers in tendering for public contracts abroad and a review of trade defence instruments (e.g., anti-subsidy instruments).

The new-generation free trade agreements are seen as an opportunity to negotiate important issues that were taken out of the multilateral negotiations at WTO (investment, procurement) or have proved too difficult for multilateral negotiations, such as most non-tariff barriers to trade, with individual trading partners. The new FTAs will typically cover the following topics: reduction of tariffs as much as possible, based on reciprocity; cutting back of non-tariff barriers to trade (e.g., technical standards, sanitary and phytosanitary measures); access to resources (e.g., energy, metals, primary raw materials); protection and enforcement of intellectual property rights; further liberalisation of trade in services; improvement of investment conditions; public procurement; competition policy, including state aid rules. Finally, a special chapter will deal with environmental and social aspects of the trade agreement.

Because of the complexity of the envisaged trade agreements, for each case a quantitative and a qualitative assessment and a "trade sustainability impact assessment" (TSIA) have to be prepared, which are not all ready yet. The quantitative analyses for the FTA with South Korea, India and ASEAN show a substantial potential increase in bilateral trade flows. However, with regard to overall welfare gains, trade diversion effects have to be taken into account as well. The qualitative assessment for India, for instance, comes to the conclusion that trade diversion resulting from tariff reduction will be quite substantial and a net positive welfare gain will depend substantially on the benefits of "deeper" integration, that is, increased investment flows, trade in services and a reduction of non-tariff barriers to trade, which will induce technology transfer, productivity increase and a better choice for consumers in the longer run. But there are critical voices, especially from the civil society, as well. Of course, the actual outcome will much depend on the details negotiated.

Finally, the new generation of EU trade agreements is being discussed in the light of the debate of bilateral versus multilateral agreements.

11. Austrian and EU trade policy contribution to sustainable development

Éva Dessewffy (Chamber of Labour, Department of EU and International Affairs)

"Global Europe" as the new trade policy strategy with its focus on bilateral free trade agreements (FTAs), is the answer to the stagnation in negotiations on WTO level and the pressure of the European industrial sector and its trade interests. But in addition, negotiations will encompass investment and public procurement issues, which were dropped from the Doha Agenda five years ago, as well as sustainable development. In insisting on reciprocity the EU will follow a more aggressive type of market access approach as compared to previous trade agreements with developing countries.

South Korea is the first country for which the EU Commission has presented a concrete textual proposal for an agreement of this new type. In respect to social issues the Commission have chosen a rather supportive approach, whereas the ambitions concerning environment remain limited. Nevertheless to pick out sustainability and environment as a central theme, through the inclusion of social and environmental topics within a separate chapter of the FTA can be deemed substantial progress. Especially the proposed formal participatory structures for civil society dialogue are a key for social and employment issues. Whether these provisions will lead to an effective application of ILO Core Labour Standards or the achievement of a higher level of environmental standards is questioned by the international trade unions movement. Ultimately it is crucial for the European Commission to get the proposed requirements accepted by its trade partners in South Korea.

12. Reasons for increases in food prices

Zdenek Lukas (wiiw), Josef Pöschl (wiiw)

Expanding global grain demand, originating from rising food consumption and agro-fuel production, coincided with a below-average grain harvest in the period from July 2005 to June 2007. The results were historically low levels of stocks in mid-2007 and sky-rocketing grain prices thereafter. This development made markets for agricultural products attractive for financial investors, especially in the context of turmoil in the stock markets starting from mid-2007. The rise in global grain prices, and in prices of other agricultural commodities as well, provoked a remarkable increase in food prices and contributed to the accelerating growth in overall consumer prices in 2008 in the EU and elsewhere. Increases in inflation were mostly driven by food and energy prices.

Consumer price inflation in the EU-(12-2)[2] accelerated more than in the EU-15. The highest increases among the EU-(12-2) have been observed in Bulgaria and in the Baltic States, the lowest in Poland and Slovakia. This has been partly due to the fact that in the consumer basket the share of food – and energy as well – is lower in the latter two countries. In addition, the currencies of the former group of countries are pegged to the euro, whereas in Slovakia and Poland strong currency appreciation acted as a buffer against imported inflation. Differences in the competitive environment are also quite significant. Only a few international supermarket chains are interested in the EU's periphery in view of its small population (market size) and limited transport infrastructure, so competition is limited in Bulgaria and in the Baltic states. Consequently, industry margins in retailing and wholesaling are high. In contrast, strong competition in the Central European food markets, e.g., in Poland and Slovakia, has mitigated the rise in food prices.

Thanks to high global grain harvests in the 2008/2009 season, grain prices have fallen in the second half of 2008. However, some agricultural commodity supplies have continued to be tight as stocks are not likely to be promptly (or sufficiently) replenished in the short run. As a result, prices will probably not return to pre-peak levels. This is true especially with regard to oilseeds and maize, where the latter represents a major staple food in poor developing countries, as well as an important input for the generation of agro-ethanol. Both oilseeds and maize are important inputs for fodder production as needed for the expanding production of meat and dairy products, items in high demand in emerging markets. In a few years' time, expanded and intensified use of land, especially in Eastern Europe and Asia, may to a certain degree offset the price impact of rising food demand. However, from a long-term perspective it seems likely that notwithstanding major temporary ups and downs, the era of cheap food is over. Within the farming sector, grain producers are likely to benefit from a long-term development of this kind, whereas this will not necessarily be the case for producers of fruit and vegetables, and especially not in the sphere of animal production. Rural areas may or may not gain from farm incomes' catching up with other industries' averages, especially where farmers are merely a small fraction of the total rural population.

[2] EU-(12-2) includes the new EU member countries Bulgaria, Estonia, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia, Czech Republic and Hungary; Malta and Cyprus are excluded.

Rather, rural development will remain mainly dependent on the degree of investment into rural infrastructure and the extent and efficiency of rural development policies in general.

wiiw

BUNDESMINISTERIUM für
WIRTSCHAFT und ARBEIT

WIFO

FIW – a collaboration of WIFO – wiiw – WSR
within the framework of “go international“