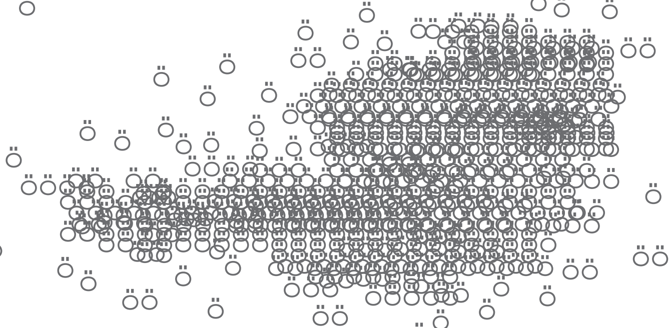
Austria's External Economic Relations 2009



FIW

Research Centre
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)
Sandra Bilek-Steindl (WIFO)
Éva Dessewffy (AK Wien)
Mariya Hake (WIFO)
Angela Köppl (WIFO)
Michael Landesmann (wiiw)
Ina Matt (WIFO)
Franz Nauschnigg (OeNB)
Harald Past (WKO)
Olga Pindyuk (wiiw)
Johannes Pöschl (wiiw)
Susanne Sieber (WIFO)
Egon Smeral (WIFO)
Roman Stöllinger (wiiw)
Waltraut Urban (wiiw)
Petra Vujakovic (JVI)

Statistical assistance: Sabine Fragner (WIFO)
Katharina Köberl (WIFO)
Irene Langer (WIFO)
Beate Muck (wiiw)
Martha Steiner (WIFO)
Eva Strobl (wiiw)
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 GmbH
Industriestraße 1, 2100 Korneuburg

All articles reflect the personal opinion of the authors. Editorial deadline for chapter 6 was 1 September 2009, for chapters 4, 5, 9, 10, 11, 13 and 14 19 October 2009, for chapters 2, 8 and 12 2 November 2009, and for chapters 1, 3 and 7 16 November 2009.

*) Initiated by the Austrian Federal Ministry of Economy, Family and Youth in the framework of the Austrian Federal Government's "Internationalisation Drive".

Contents

Global Economy 5

1. Developments in the world economy 5

2. Global economic and institutional environment 7
2.1 The world economy at a glance 7
2.2 Economic outlook for industrialised countries, the CEEC and emerging markets 8
2.3 Institutional environment and trade relations 9

3. Developments in world trade 11
3.1 General developments 11
3.2 International trade in goods 11
3.3 International trade in services 13
3.4 Global foreign direct investment 13

Austria's External Economic Relations 15

4. Economic development, price competitiveness and an overview of Austria's external economic relations 15
4.1 Economic development (including outlook for 2009 and 2010) 15
4.2 Price competitiveness 16
4.3 Overview of Austria's external economic relations – trade in goods, services and foreign direct investment 17
4.4 The New Globalisation Index (NGI): How globalised is Austria? 18

5. Austrian trade in goods 19
5.1 Development in 2008 and outlook for 2009 19
5.2 Regional structure 19
5.3 Sectoral structure 20
5.4 Trade balance development 21
5.5 Focus: Austrian environmental technology industry – foreign trade and competitiveness 21

6. Austrian trade in services 23
6.1 Austrian trade in services since 1998 23

6.2	Trade in services according to main categories	23
6.3	Regional structure of trade in services	24
6.4	Focus: trade in financial and insurance services	25
6.5	Tourism	25
7.	**Austrian foreign direct investment**	**26**
7.1	Austria's position in international comparison	26
7.2	Austrian outward foreign direct investment	26
7.3	Austrian inward foreign direct investment	28
8.	**Specialisation and competitiveness of Austrian trade**	**28**
8.1	Importance of sophisticated sectors, specialisation and Austrian export market shares	28
8.2	Intra-industry trade with CEEC-10	29
8.3	Regional diversification	31

Special Topic: New Protectionism – A Threat to World Trade? **32**

9.	**Free trade and protectionism – theoretical arguments and current measures by the EU, the USA and China**	**32**
9.1	Introduction	32
9.2	Free trade vs. protectionist measures	32
9.3	Current measures by the EU, the USA and China	33
10.	**Government influence on the economy and global open markets**	**34**
10.1	Introduction	34
10.2	State interventions in the financial sector	34
10.3	Firm subsidies and fair competition on global markets	35
10.4	Public procurement as a protectionist tool	36
10.5	Conclusions	36
11.	**Trade liberalisation versus trade protectionism in times of economic recession**	**37**
12.	**The importance of non-tariff barriers in the crisis**	**37**
13.	**Two World Economic Crises – A Comparison**	**38**

Global Economy

1. Developments in the world economy

Michael Landesmann (wiiw)

This introductory chapter examines the implications of the global economic crisis for medium and longer term developments in international economic relations.

The first issue to be analysed is the potential impact on medium to long term growth trends in advanced economies. While the recent crisis has mostly been compared to the crisis in the 1930s, which also had its origins in financial markets, there are also certain parallels with the aftermath of the oil crisis of 1973. The energy crisis generated a change in growth trends which lasted roughly until the mid-1980s and which generated difficult adjustment problems in the form of distributional conflicts, inflationary tendencies, and sustainability problems in the public debt situation. We expect the recent crisis to lead to a medium-term increase in capital costs, a protracted process of deleveraging of private sector debt, an increase in savings rates and constraints on fiscal spending, all of which will have a growth-dampening effect in the medium term.

A second issue relates to likely differences in economic policy reactions in the USA and in Europe (specifically the euro area) in the recovery phase after the crisis. Given the different constitutions of the Fed and the ECB, we expect different reactions of monetary policy authorities. Resultant higher inflation rates in the USA would lead to a drop in public debt in real terms, while the Euro zone will have to attempt to bring the fiscal situation under control through a more restrictive stance. These differences would, by themselves, generate an upward pressure on the euro exchange rate vis-à-vis the US dollar and reduce growth rates in Europe relative to the USA.

Another reason for an upward pressure on the euro – which also has a growth-dampening impact in Europe – is, of course, the unwinding of global imbalances, which looks as if it might continue to occur mostly through US-European exchange relations rather than through relations with other trading partners (China, oil producers) where these imbalances mostly originate. It is not likely that this path will lead to a longer-term solution of the problem of imbalances in the global economy, and instabilities in foreign exchange markets are likely to recur.

A third issue is the transmission of the crisis to the countries of Central and Eastern Europe (CEEC). The growth decline in the CEE region due to the crisis was stronger than in any other region in the world. This was somewhat of a surprise as the financial markets in the CEE economies were relatively underdeveloped and in most cases not directly linked to the types of transactions (in sub-prime mortgages, complex financial instruments, etc.) from which the crisis originated. However, there were a number of channels through which the crisis was transmitted to CEE economies with not only short-term but also longer-term implications for the type of growth model which this region is likely to be able to pursue in the future. The change in risk sentiment in global markets more generally and the changed balance sheet position of foreign banks operating in the region caused a much more restrictive stance towards capital flows into the region. The CEEC were particularly vulnerable on this account, as their growth and catching-up processes had become strongly dependent upon such flows. However, there were significant differences across different groups of economies, as Central European economies had become successful exporters, while the countries of South Eastern Europe and the Baltics had undergone very dramatic processes of de-industrialisation from which they never fully recovered. The choice of exchange rate regime and the important factor of remittances also played a role in building up vulnerable and unsustainable positions leading to the crisis. In this respect, the main issues to be faced by different groups of CEE economies are the importance of strengthening the tradable sector, the reform of fiscal structures, the choice of exchange rate regimes, and trade and production diversification.

As far as prospects for the global economy and shifting patterns of trade and growth in international economic relations are concerned, this yearbook includes a separate set of papers on developments with regard to trade policy and new forms of protectionism. The assessment to date is that these forms of protectionism have not gained very worrying proportions so far. On the other hand, a number of graphs in this yearbook show that the global crisis has indeed had a serious impact on world trade, reflecting the high degree of international connectedness of the current global system. As a result, traditionally successful exporters (Germany, countries in Central Europe, Japan, China) felt the impact of the crisis particularly through this channel. Among the groups of emerging economies, it is interesting that past experiences of the Asian and Latin American crises left their traces in the adoption of new strategies in these economies which included the building up of buffers (reserves, fiscal) against external shocks. This meant that they were less affected by the current crisis and hence their strategies might be adopted by a wider range of countries in the future. Finally, it is observable that the crisis has strengthened differences in growth patterns between advanced and (important groups of) emerging economies, leading to shifting weights in the global economy and in political economic relationships. Switches in the relevance of different political decision-making bodies (the G-20) as well as reforms in voting shares in relevant international organisations (especially the IFIs) will reflect these shifts. Differences in long-term growth patterns will also have an impact on patterns of global and regional integration, for example the trends towards increased regional integration amongst Asian economies that have already been observed.

2. Global economic and institutional environment

Vasily Astrov (wiiw), Olga Pindyuk (wiiw), Roman Stöllinger (wiiw), Waltraut Urban (wiiw)

2.1 The world economy at a glance

In winter 2008/2009, the world economy experienced its greatest recession in the post World War II era. The economic downturn was triggered by a financial crisis in the USA that intensified considerably in September 2008. Economic growth rates had already started to recede earlier in industrialised countries that were directly affected by the financial crisis, but after the events of September 2008, the economic crisis reached a global dimension as lack of import demand in industrialised countries led to severe declines of exports in emerging markets and in Central and Eastern European countries (CEEC). Growth rates in some major emerging markets such as China, India or Turkey receded more strongly in 2008 compared to 2007 than in the USA, mainly because pre-crisis growth rates were much higher. Due to the outbreak of the economic crisis, global GDP grew by only 1.8 percent in 2008, a marked falloff compared to 2007 (+3.8 percent).

The full severity of the crisis, however, is only discernible in quarterly data, because in several countries growth was still intact in the first half of 2008. In the fourth quarter of 2008 and the first quarter of 2009, negative growth rates were registered in the USA, the euro area, the United Kingdom, Japan and many other industrialised and emerging countries. The decline in GDP amounted to about 5 percent in the euro area and more than 8 percent in Japan for the first quarter of 2009[1]). The downturn in the CEEC, although it set in somewhat later than in the industrialised countries, was dramatic due to the export orientation of these countries and their dependence on external financing.

By mid-2009, however, the global economy seemed to have passed the trough of the economic downturn and some countries already

[1]) Compared to the same quarter of the previous year.

registered positive GDP growth (on a quarter-on-quarter basis) in the second quarter of 2009 (e.g. Germany). In China, economic activity had picked up even earlier, and most positive impulses for the recovery are expected to come from Asia.

An interesting feature of the crisis is the development of exchange rates. Despite the fact that financial crises typically cause the domestic currency to depreciate, the US dollar appreciated strongly after the default of Lehman Brothers in September 2008. This development can be explained by altered risk perceptions of investors and a "flight into quality", i.e. the increasing preference for lowest-risk securities including US Treasury bonds. Since April 2009, however, the US dollar has been weakening against the currencies of major US trading partners. In the euro area, the recent dollar weakness has caused concerns about the competitiveness of EU exports to the USA.

For 2009, the world economy is expected to shrink by about 2 percent to 2.5 percent. While GDP in almost all industrialised countries will decline, the (heterogeneous) group of emerging markets could grow at a moderate rate of 2 percent, although this figure is strongly dependent on the growth performance of China and India, which seem to be returning to their pre-crisis growth paths earlier than many industrialised countries, in particular those that were directly hit by the financial crisis.

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

Industrialised countries. Economic recovery in most industrialised countries (including the **USA**, the **euro area**, the **United Kingdom** and **Japan**) will be a slow process. The return to growth may be somewhat faster in countries that were badly hit by the economic crisis via the trade channel but comparatively less affected by the financial crisis, such as the export-oriented economies of **Germany** and **Japan**. GDP in these countries is expected to grow by 1.2 percent and 1.5 percent respectively, while in the **United Kingdom,** which suffered huge losses from the financial crisis, growth is likely to remain below 1 percent in 2010. In the **USA**, growth prospects for 2010 are also modest (+1.5 percent) because private consumption, the former growth engine, will only expand very mildly in 2010 (+0.5 percent). In basically all industrialised countries, the economic recovery that got underway around mid-2009 has been strongly supported by fiscal stimulus measures. In many countries, public finance will be a big challenge in the years to come, either because of the size of the stimulus packages and the costs of financial bail-outs (**USA**, **United Kingdom**) or because government debts were already very high before the economic crisis (**Italy, Japan**). In **France** and **Germany** (as well as in other euro area countries), stronger automatic stabilisers helped to cushion the economic downturn, but high unemployment will be an obstacle to growth.

CEEC and Russia. The adverse impact of the global crisis on the **Central and Eastern European countries** (CEEC) has been reinforced by their backward export structure (e.g. in the **Western Balkans**) and the generally high external indebtedness (particularly in the **Baltic countries**, whose economies are expected to decline by close to 20 percent in 2009). Of all CEEC, only **Poland** and **Albania** are expected to avoid recession in 2009 and post positive growth next year. In other countries, the economy in 2010 will either stagnate or decline markedly (once again in the **Baltics**). The **Russian** economy has suffered as a result of the collapse of oil prices in the second half of last year, whereas the large-scale fiscal stimulus has had little effect so far. GDP is expected to decline by at least 6 percent in 2009, although the recent ruble devaluation should enable a moderate recovery in the years thereafter.

Emerging markets. Initial hopes that the emerging markets would be able to "decouple" from the financial and economic crisis triggered by the advanced industrialised countries have not materialised. The main mechanism of transmission is represented by rapidly declining exports and the reversal of capital flows. However, the impact of the crisis varied widely across countries, also depending on the scope and effectiveness of policy measures implemented to contain the crisis. In **China** and **India**, despite significant decline, GDP growth stayed high by international standards, but in **Brazil**, **South Africa** and **Turkey** the economy contracted. In **Brazil**, however, the contraction was relatively mild and a recovery seems to be on its way already, as in **China** and **India**. **Turkey** was hit particularly hard by the crisis and GDP is expected to fall by 6.5 percent in 2009. So far, **South Africa** and **Turkey** show only few positive signs, such as a revival of direct and portfolio investment inflows, but their basis for growth in 2010 is not bad.

2.3 Institutional environment and trade relations

Multilateral developments. The Doha round of WTO negotiations remains at an impasse, and chances of its fast completion have declined. Not only have the reasons which put it into the deadlock not been solved, but the global economic recession and associated job losses have been fuelling protectionist pressures and decreasing incentives for liberalisation under Doha. As in previous business cycle downturns, the 2008-2009 crisis has led to a rise in antidumping investigations and other protectionist measures. In December 2008, plans to hold a meeting to seek a breakthrough on Doha were dropped because of an unacceptably high risk of failure. Meetings of the G-20 in April, July and September 2009 reiterated the desire to reach a Doha deal, but no exact steps or deadlines were set, and no exact promises on refraining from the recent protectionist measures in violation to the WTO rules were made.

Currently there are 153 members in the WTO and 30 countries conducting accession negotiations, Russia being the biggest economy among them. In June 2009, Russia announced that it intends to enter the WTO not on its own but as a customs union with Belarus and Kazakhstan; thus, de facto the negotiations on the WTO accession have been stopped.

Trade relations of the EU. Based on its new trade policy strategy, the EU is continuing its bilateral free trade negotiations with a strong focus on South East Asia. The latest success is the free trade agreement (FTA) with South Korea (signed in October 2009 but not yet in force) which is a WTO-plus agreement, meaning that it goes far beyond tariffs on trade in goods. Negotiations on an FTA with a broad coverage are also underway with India and ASEAN countries.

No progress has been achieved with regard to the Economic Partnership Agreements the EU envisages in its relations with the African, Caribbean and Pacific Group of States (ACP-countries) and in FTA negotiations with MECOSUR and the Andean community.

Trade relations of the USA. As of October 2009, the USA has 17 FTAs in place (including NAFTA partners Canada and Mexico). In addition to that, three FTAs are waiting for ratification, including the important agreement with Korea. The prospects of the new US administration's ratifying the FTA with Korea in the near future are not very high. This is because the USA is currently in the process of revising the benchmarks for new agreements to be concluded. Also, more emphasis might be put on the enforcement of existing agreements than on the implementation of existing ones.

Economic Integration in Asia. In December 2008, the ASEAN Charter, a kind of constitution signed a year ago, was put into force. At the ASEAN Summit in February 2009, a US$ 120 billion Crisis Fund was set up by the ASEAN countries, China, Japan and South Korea to safeguard regional financial stability. Also, a free trade agreement between ASEAN, New Zealand and Australia was signed. On 1 January 2010, the free trade area between ASEAN and China, comprising 1.8 million people, is scheduled to come into force.

At the APEC Summit in November 2009 in Peru, the 21 member countries pledged not to implement protectionist measures for the next 12 months.

In the light of the crisis, the Shanghai Cooperation Organisation focussing on security issues among 4 Central Asian countries, Russia and China is striving for closer economic cooperation.

Economic Integration in South America. South America's largest economic bloc, MERCOSUR, continues to struggle with internal differences and has not yet managed to abolish the doubly levying of the common external tariff. Moreover, Venezuela's accession is still pending ratification and Uruguay's exit from MERCOSUR remains an issue because of its aspirations to conclude an FTA with the USA.

In the Andean Community, internal controversies emerged over the FTA negotiations with the EU that were re-launched at the beginning of 2009.

3. Developments in world trade

Roman Stöllinger (wiiw)

3.1 General developments

Trade in goods and services continued to expand in 2008, achieving increases of 15 percent and 11 percent respectively (in nominal terms)[2]), despite the severe drop in global trade in the last quarter of the year, a development that continued in the first quarter of 2009. Foreign Direct investment (FDI) flows, however, already registered a decline of 13 percent in 2008 on an annual basis. Global goods exports accounted for approximately 75 percent of total trade and investment flows, which totalled US$ 21.4 trillion.

3.2 International trade in goods

After a peak in April 2008, the volume of global goods trade started to decline as a consequence of the economic downturn and dwindling import demand, primarily from industrialised countries. Towards the end of the year, the decline in trade volumes accelerated, reaching 7.1 percent in the fourth quarter of 2008 and a further drop of 11.2 percent in the first quarter of 2009. In mid-2009, world trade became stabilised, but at a relatively low level (comparable to that of 2005). In June and July 2008, some mild expansion of the world trade volume was registered.

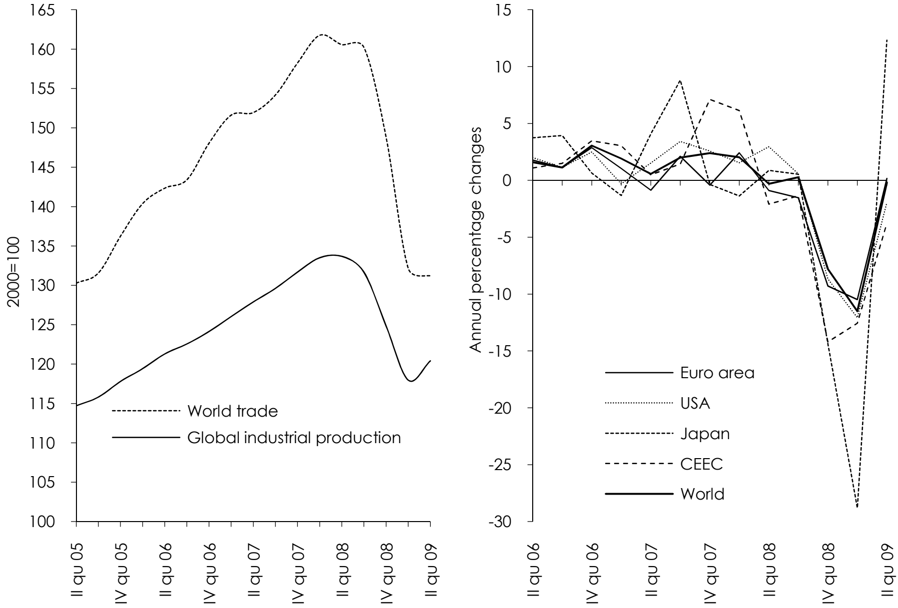
The drop in global goods trade was particularly strong in export-oriented industrialised countries such as Japan, but also in the Central and Eastern European Countries (CEEC). The decline in export volumes in the euro area and the USA was of similar magnitude (Figure 3.1, right).

An important feature of the 2008/2009 crisis is the more than proportional fall in trade volumes compared to GDP or industrial production (Figure 3.1, left). There are a number of possible reasons for this. One explanation brought forward is that exports suffered particularly from the shortage of finance caused by the financial crisis because of the

[2]) Part of the expansion in nominal world trade is due to price effects.

heavy dependence of exports on various forms of trade credit. According to estimates, as much as 80 to 90 percent of world trade relies on some sort of trade finance.

Figure 3.1: Real development of global goods trade and global industrial production (left) and goods exports in selected countries (right)



Source: CPB world trade database. – Quarterly figures are 3-month averages (momentum). Central and Eastern European Countries (CEEC) according to country classification of the CPB.

Another reason for the more than proportionate decline in goods trade is the fact that the deepening of trade relations in the form of vertical trade (that implies trade in intermediates and other inputs) inflates trade values. When inputs are exported, processed abroad and then re-imported, a double counting of trade flows occurs because trade statistics are based on gross values rather than value added. More generally, double counting occurs in global production chains when complex products are fabricated not in one place but in several (international) locations, with each country specialising in certain stages of production. International (or regional) production networks play a particularly large role in South East Asian trade relations (e.g. the share of vertical trade in Singapore comes to 66 percent). The double counting of exports creates a type of multiplier effect, meaning that an increase in production typically entails a more than proportionate decline in exports.

Yet another reason for the trade development in the winter of 2008/2009 is the composition of world trade compared to GDP. World trade is dominated by trade in industrial goods, which is not the case for GDP. The loss of consumer confidence and pessimistic business expectations on the part of firms affected consumer durables and capital goods to a particularly great extent. This can be seen clearly in trade data on a (broad) product category level (e.g. for the EU-27). These two goods categories are also particularly important in world trade, comprising 35 percent of total goods trade (2008).

All the factors mentioned above – dependence on trade finance, highly fragmented production processes and the loss of consumer confidence – are relevant for the especially badly hit automobile industry, which accounts for 7 percent of world trade and 10 percent of OECD trade.

3.3 International trade in services

Trade in services continued to expand in 2008 (on an annual basis) and, overall, was less affected by the global downturn than trade in goods.

From a long-term perspective, services apart from the traditional sectors (transportation and tourism) have grown much more dynamically over the last decades, with the result that "other services"' have become the most important category, accounting for about 50 percent of total services trade in 2008. Within this broad category of services, financial services and other business-related services are the largest sectors, both globally and in the EU. Nevertheless, specialisation in services differs greatly from one country to another, with the USA and the United Kingdom showing a very strong specialisation in services generally, stemming from (revealed) comparative advantages in patents and licences, tourism and financial services in the USA and financial services in the United Kingdom. In contrast, Germany and Japan specialise heavily in exports of industrial goods, with disadvantages in almost all groups of services.

Despite the generally greater resilience of services trade to the economic recession, some sectors such as transportation and financial services also showed highly negative growth rates. In the case of transportation, this was also evident in the drastic fall in freight rates (e.g. the Baltic Dry Index).

3.4 Global foreign direct investment

As a result of low mergers and acquisitions activity (M&A activity) and reduced profits in foreign affiliates, outward FDI of companies from industrialised countries fell by 17 percent and FDI inflows into those countries dropped even more severely (–29 percent) in 2008. The large share of industrial countries in FDI flows (outward flows: 80 percent; inward flows: 60 percent) caused global flows to decrease by 14 percent. FDI flows, both inward and outward, of developing countries and CEEC still grew in 2008 (on an annual basis), but turned negative in the first quarter of 2009, when the global downturn accelerated.

Reduced M&A activity was the major reason for the drop in FDI flows in 2008, but greenfield investments declined as well. The importance of these types of FDI (as opposed to reduced profits of affiliates and intra-company loans) could indicate that the recovery of global FDI activities may be a slow process.

Looking at the various sectors, services industries seem to be more affected by the negative FDI trend than manufacturing (–54 percent compared to –10 percent in 2008 for M&A values). A particularly large decline in M&A values was observed in financial services, which registered a drop of 73 percent.

The prospects for FDI in 2009 are rather gloomy, with UNCTAD expecting global flows to decline to a value between US$ 900 billion and US$ 1,200 billion, as compared to US$ 1,700 billion in 2008 (in terms of inward FDI flows). Similarly, the OECD estimates that FDI inflows to OECD countries may drop to US$ 600 billion. With the situation stabilising somewhat in the second quarter of 2008, the final figure for 2009 could be somewhat higher than these forecasts, but recovery is nevertheless likely to be slow, with flows in 2011 expected to remain below the record level of 2007.

FDI by multinational firms is not an end in itself, but rather an alternative to exports in a firm's internationalisation strategy[3]). Sometimes the creation of an affiliate abroad is the sole possibility to access a foreign market; this is especially true for certain services industries. Therefore, the sales of foreign affiliates of multinational firms are of interest when comparing the relative importance of exports and FDI in firms' globalisation strategies. It turns out that foreign affiliate sales are particularly important in large industrialised countries such as Japan or the USA – in the latter, the ratio of foreign affiliate sales to exports exceeds two. In Germany, however, exports are still higher than sales of foreign affiliates owned by German firms. Foreign affiliate sales are still of minor importance in CEEC countries.

[3]) Exports and FDI can also be complementary, e.g. in cases where a foreign affiliate is set up as a regional hub for serving neighbouring markets, or if FDI is motivated by efficiency considerations (e.g. lower labour costs) and the purpose of the foreign affiliate is to process imported inputs and re-export them.

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 2009 and 2010)

Sandra Bilek-Steindl (WIFO)

Following the boom years 2006 and 2007 (+3.5 percent in each year) the Austrian economy began to lose momentum in the course of 2008. In line with the global economy, at the end of the year Austria entered the worst recession since the Second World War. Due to the fact that expansion was still dynamic in the first half of the year, the economy grew at a rate of 2.0 percent over the year 2008. Against the background of the downturn in the most important export markets, goods exports and industrial activity contracted at the end of the year. Investment in machinery and equipment, as well as in construction, also lost momentum. Consumer expenditures of private households remained sluggish over the year because of stagnating real per-capita gross earning. Inflation peaked in June at 3.9 percent, with the largest upward contribution coming from the prices of fuel and other energy sources. The average inflation in 2008 amounted to 3.2 percent. The economic slowdown began to take hold of the labour market at the end of the year as well. But on an annual average, the number of persons in active dependent employment still increased at a rate of 2.4 percent, while unemployment continued to drop.

The downturn sharpened in the first quarter of 2009. The Austrian economy shrank by 2.7 percent compared to the previous quarter. This development was much more severe than in the past recessions in Austria in 2001 and 1993. Especially goods exports and industrial activity contracted sharply in the first quarter of 2009. Substantial fiscal counter-cyclical measures were instituted in Austria and other industrialised countries, with first effects already showing in the second quarter. The second quarter saw the strong downturn starting to level off, and business cycle surveys suggest that a further improvement can be expected in the second half of the year. Especially the industrial cycle is expected to recover, stimulated by special measures such as international car-scrapping premiums and the inventory cycle. In any event, over the year 2009 the Austrian economy is expected to decline by 3.4 percent. While exports of goods and tourism as well as investment demand are expected to decline over the year, consumption expenditures will help to stabilise the economy. Besides the tax reform and the car-scrapping premium, high real per-capita gross earnings are supporting private consumption expenditures. Inflation is declining on an annual basis, with an expected headline inflation of 0.5 percent in 2009. Labour market conditions will worsen in reaction to the business cycle with a decline in persons in active dependent employment and an increase in unemployment. Mainly in the industrial sector, which was hit the hardest, the government introduced measures to facilitate recourse to short-time work.

In 2010 the economy is expected to stay weak, but fiscal counter-cyclical measures are allowing the recovery to continue. At all events, the underlying dynamics will be weak, with an expected annual growth rate of 1 percent. Industrial production will recover only at a slow pace, because special measures are being phased out in 2009. Investment in machinery and equipment as well as in infrastructure will be slightly widened, mainly stimulated by the fiscal counter-cyclical measures. Private consumption expenditures will again provide a positive contribution to growth. While real per-capita gross earnings are expected to stagnate, lagged effects of the tax reform will stabilise consumption expenditures. In 2010, the rebound in oil prices will push inflation up to 1.3 percent. Automatic stabilisers and fiscal counter-cyclical measures are putting a burden on public households. While the public deficit is increasing, public debt will be enlarged, too.

4.2 Price competitiveness

Susanne Sieber (WIFO)

International price competitiveness is one important factor influencing export performance, especially in the short run; main indicators for competitiveness are the relative unit labour costs and the real effective exchange rate. The Austrian position of the relative unit labour costs in manufacturing improved compared to Austria's trading partners ant to Germany in 2008. However, the real effective exchange rate, which increased by 0.6 percent in 2008, again had a negative impact on the competitiveness of Austrian foreign trade.

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

First negative effects of the world economic crisis are already observable in the figures of 2008. The Austrian exports of goods quota – measured in percent of GDP – decreased in 2008 for the first time, after a clear trend of improvement over the previous years.

The Austrian exposure to Central and Eastern European Countries is a hot topic in economic policy discussions. In 2008, 23.3 percent of all trade in goods and 19.1 percent of all trade in services already went to the CEEC-21. Almost half of all Austrian outward foreign direct investment stocks are invested in the CEEC-21.

Table 4.1: Importance of CEEC for Austria's external relations

	2008				2007	
	Trade in goods		Trade in services[1]		FDI stocks	
	Million €	Percentage shares	Million €	Percentage shares	Million €	Percentage shares
Exports, outward FDI						
Intra-EU 15	64,144	54.6	25,887	61.0	30,499	29.7
CEEC-21	27,334	23.3	8,101	19.1	51,113	49.8
CEEC-10	20,536	17.5	5,794	13.7	33,706	32.9
Other CEEC[2]	6,798	5.8	2,307	5.4	17,407	17.0
EU-12	20,655	17.6	5,959	14.0	36,157	35.2
Extra-EU 27	32,726	27.8	10,472	24.7	35,928	35.0
Total	117,525	100.0	42,435	100.0	102,584	100.0
Imports, inward FDI						
Intra-EU 15	73,554	61.5	15,781	54.4	68,970	63.8
CEEC-21	18,769	15.7	7,287	25.1	3,244	3.0
CEEC-10[3]	14,414	12.1	5,230	18.0	113	0.1
Other CEEC[2][3]	4,355	3.6	2,057	7.1	3,120	2.9
EU-12	14,465	12.1	5,376	18.5	1,837	1.7
Extra-EU 27	31,550	26.4	7,855	27.1	37,278	34.5
Total	119,568	100.0	29,012	100.0	108,085	100.0

Source: Statistics Austria, OeNB, WIFO calculations. – [1]) Sum of countries differs from total. – [2]) Albania, Belarus, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Moldova, Montenegro, Russia, Serbia, Ukraine. – [3]) FDI: estimates.

4.3.2 Trade in the national accounts

In spite of the first negative effects of the world economic crisis, the nominal balance of trade in goods and services was still positive in 2008; the positive contribution to the trade balance was nearly solely due to the trade in services figures. In contrast to the positive contribution of real net exports of goods and services to economic growth in previous years, a negative impact is expected for 2009.

4.4 The New Globalisation Index (NGI): How globalised is Austria?

Petra Vujakovic (JVI)

Measuring a complex social phenomenon such as globalisation is never easy. In choosing variables, it is important to cover the most important aspects and capture the multidimensionality of this phenomenon. The NGI is a composite globalisation index consisting of 21 variables. From this data set, three dimensions of globalisation emerged with the help of principal component analysis – a financial dimension, a trade and politics dimension, and a social dimension.

Most standard globalisation indicators measure the simple "openness" of a country, which makes it hard to distinguish between globalisation and regionalisation. The idea for tackling this problem in the NGI is to introduce geographical distance as a distinguishing feature of globalisation. This was done in the case of the "trade in goods" variable, by means of weighting the bilateral trade data with the geographical distance between the respective countries. In this way, the relationships between distant countries obtain a higher score than trade between neighbouring countries, which is more regional integration than it is globalisation.

Austria ranks ninth in the NGI. Looking more closely at the dimensions, its lower part of the result seems to be the financial globalisation. Additionally, the adoption of the geographical distance weights in the "trade in goods" variable corrected the score for Austria downwards. It is an open country in trade terms, but its trade relations are highly concentrated on the European region. This shows that Austria is very well integrated within the region, which includes both Eastern and Western Europe. As far as its global relations are concerned, there is still room for improvement, even though its position in the top 10 most globalised countries seems very stable.

5. Austrian trade in goods

Susanne Sieber (WIFO)

5.1 Development in 2008 and outlook for 2009

The first negative effects of the global crisis resulted in a slowdown of dynamics in 2008. In total, goods with a value of € 117.5 billion were exported in 2008; thus, nominal exports increased by 2.5 percent. Nominal imports rose by 4.7 percent, with the value of all imported goods amounting to € 119.6 billion. Real figures show just a slight increase for 2008 (exports: +0.25 percent, imports: +0.19 percent). At the beginning of 2009, foreign trade was hit further by the global crisis. Due to the unfavourable international environment, especially the shrinking global demand, nominal exports decreased by 24.7 percent in the first half of 2009.

Table 5.1: Overview of Austrian trade in goods

	2006	2007	2008	2009[1])	2009 First half year
Exports			Billion €		
Values	103.7	114.7	117.5	97.3	45.8
			Annual percentage changes		
Values	+ 9.5	+ 10.5	+ 2.5	– 17.2	– 24.7
Real	+ 6.4	+ 9.0	+ 0.3	– 15.1	.
Prices	+ 3.0	+ 1.4	+ 2.2	– 2.5	.
Imports			Billion €		
Values	104.2	114.3	119.6	101.4	47.6
			Annual percentage changes		
Values	+ 8.0	+ 9.6	+ 4.7	– 15.2	– 21.4
Real	+ 4.1	+ 7.6	+ 0.2	– 11.2	.
Prices	+ 3.7	+ 1.9	+ 4.5	– 4.5	.
Balance			Billion €		
Values	– 0.5	0.4	– 2.0	– 4.1	– 1.9
Change	1.3	0.9	– 2.5	– 2.1	– 2.0
			Annual percentage changes		
Terms of Trade	– 0.7	– 0.5	– 2.1	+ 2.1	.

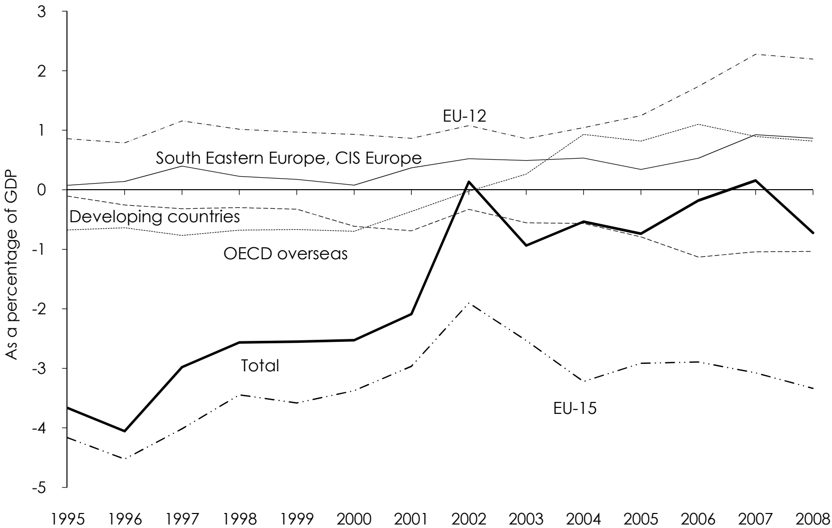
Source: Statistics Austria, WIFO calculations. – [1]) WIFO Forecast September 2009.

5.2 Regional structure

In total, Austrian exports to the CEEC-10, as well as the extra-EU-27 trade, still increased in 2008. However, in the last quarter of 2008, trade with the 21 Central and Eastern European countries (CEEC-21) was already decreasing. In the first half of 2009, trade with nearly all trading partners shrank due to decreasing international demand, with the exception of exports to China, which increased by 5.3 percent in the first seven month of 2009.

The importance of the CEEC-21 for Austrian exports has increased over the years; in 2008, 17.5 percent of all Austrian exports went to the CEEC-10, 23.3 percent in total to the CEEC-21. Four out of the ten most important export partner countries in 2008 were from the CEEC-21 (Czech Republic, Hungary, Poland and Russia). Although Austrian exports had already reached an extraordinarily high market share level, they gained additional market shares in Slovakia, Hungary, the Czech Republic and Slovenia in 2008.

Figure 5.1: Austrian trade balance



Source: Statistics Austria, WIFO calculations.

5.3 Sectoral structure

Among the sectors mostly affected by the global crisis is the export of transport equipment, especially motor vehicles. Exports of the latter decreased by 27.3 percent in 2008, and according to preliminary data, exports fell by 60 percent in the first half of 2009. One of the few sectors which still had positive growth rates of export values in the first half of 2009 was pharmaceutical products. The price increase in energy in the first half of the year 2008 resulted in a large increase in import values, namely +28.6 percent, in 2008. Hence, the share of energy imports in total imports increased from 9.8 percent to 12 percent.

5.4 Trade balance development

After the positive trade balance in 2007 – for the second time since World War II – the foreign trade balance was again negative in 2008 (€ –1.7 billion). This deterioration can be traced back to a price effect. Due to considerable price increases in the first half of the year 2008 – mainly as a result of a remarkable increase of energy and raw material prices – terms of trade deteriorated again in 2008. Nevertheless, over the last years the Austrian trade balance has shown a clear trend towards improvement (Figure 5.1). Despite the deterioration of the Austrian trade balance with most partner countries, trade with the new EU member states Romania and Bulgaria resulted in a clear improvement of the trade balance in 2008 (€ +0.3 billion).

5.5 Focus: Austrian environmental technology industry – foreign trade and competitiveness

Angela Köppl (WIFO)

Over a period of slightly less than 15 years, the environmental industry has shown a very dynamic development in Austria. Starting from the development of solutions for national and local environmental problems, the activities of the industry have increasingly shifted towards international markets. In the mid-1990s, approximately 50 percent of the turnover with Austrian environmental technologies was achieved on foreign markets; by 2007 this share had risen to two thirds.

Shifts in environmental policy issues and an increasing internationalisation and globalisation of the environmental industry have raised competitive pressure in this sector. The growing globalisation has been intensifying competition for domestic suppliers both in foreign markets and in Austria.

In order to measure the competitive position of the Austrian environmental technology industry, calculations were carried out based on the UN world trade database. In 2000, the OECD published a preliminary list of environmental goods that can be identified in the UN world trade database by means of the Harmonised System classification[4]). There are a few problems with respect to this list, in particular regarding the compilation of data in the field of clean technologies and multi-purpose goods. As an approximation for delimiting the environ-

[4]) Harmonised System, international goods classification; OECD, "Environmental Goods and Services. An Assessment of The Environmental, Economic and Development Benefits of Further Global Trade Liberalisation", Joint Working Party on Trade and Environment, 2000, (86).

mental industry, however, the OECD list of goods can certainly serve as a valuable base to calculate indicators of the competitive position for Austria and other countries.

The first indicator refers to the development of the market share (a country's proportion of the OECD countries' global exports of environmental goods). In terms of the OECD foreign trade in environmental technologies in 2005-2008, Germany ranked first (22.4 percent), followed by the USA (14.6 percent) and Japan (13.2 percent). Other countries holding considerable market shares are Italy (7.8 percent) and France (5.3 percent). With an average share of 1.9 percent in 2005-2008, Austria is approximately on a par with Sweden, Spain and Denmark.

Measured in terms of the relative competitive position[5], Austrian international trade in the period 2005-2008 evinced a specialisation in environmental technologies, an improvement over the period 2002-2004, during which this indicator was negative. Other countries also show significant fluctuations in the value of this indicator. The development of the RWS values is determined not only by a change in the volume of foreign trade in environmental technologies, but also by changes in total foreign trade in goods[6]).

Of the European countries, Germany, Denmark, Italy and Switzerland have specialised in international trade in environmental technologies since 1998-2001. For non-European countries, this is true for the USA and Japan.

In terms of the RCA value (revealed comparative advantage), an increase in import competition is observable for Austria in the environmental technologies sector.

---

[5]) Relative world trade share or market share (RWS): This indicator relates a country's share of the trade in environmental goods to its share of exports of processed industrial goods in general. A value of zero means that the export of the category considered has the same percentage of OECD exports as do total exports. A positive value means that the world trade share or market share of the category considered is higher than the average of exports. The higher the share held by environmental goods in a country's total exports in goods in international terms, the higher the value of this indicator will be.

[6]) Calculations made by *Legler et al.* (2003) also found a negative RWS value for Austria in 2000;. Legler, H., Schmoch, U., Gehrke, B., Krawczyk, O., "Innovationsindikatoren zur Umweltwirtschaft", Studien zum deutschen Innovationssystem, Niedersächsisches Institut für Wirtschaftsforschung im Auftrag des Bundesministeriums für Bildung und Forschung, Berlin, 2003, (2).

6. Austrian trade in services

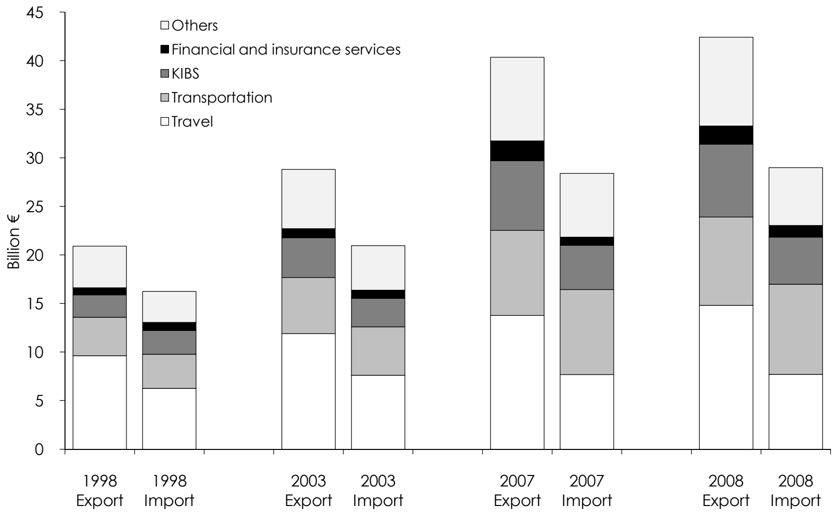
Mariya Hake (WIFO)

6.1 Austrian trade in services since 1998

After a decade of successful and increasing trade activities, no decline in Austrian trade flows in services was noted in 2008. Compared to the previous year, exports in services grew by 5.1 percent and imports by 2.1 percent. In absolute numbers, exports amounted to € 42.4 billion and imports to € 29 billion. Compared with 1998, the share of exports in nominal GDP grew up to 15.1 percent, whereas imports amounted to 10.3 percent in 2008 (as compared to 8.5 percent in 1998). Moreover, services constitute the driving power of the current positive balance of payments.

6.2 Trade in services according to main categories

Figure 6.1: Development of the structure of services trade, 1998 – 2008



Source: OeNB.

No significant displacement took place between 2007 and 2008 with respect to the main categories of services. An important feature of recent years, however, is the restructuring of trade in services towards KIBS (knowledge intensive business services). Nevertheless, the highest trade flows occurred in travel exports, which reached a value of

€ 14.8 billion in 2008, whereas imports amounted to € 7.7 billion. This sector again managed to achieve a surplus (€ 3.4 billion). The service category transport showed a slightly negative balance in 2008 (€ –0.2 billion), with the sub-category "transport of passengers" showing a loss in exports. The negative balance of "freight transport" (€ –0.5 billion) was the main contributor to the deficit of this position.

The share of KIBS in total services exports has shown strongly positive growth since the mid-1990s. Whereas in 1998, KIBS exports amounted to 10.9 percent of total services exports, or 1.2 percent of GDP, in 2008 KIBS exports accounted for 17.7 percent (2.7 percent of GDP). Compared to the previous year, KIBS exports and imports both rose in 2008 (by 4.4 percent and 6.6 percent, respectively).

Despite the economic crisis and falling services trade volumes, KIBS exports in the first quarter of 2009 remained stable compared to the first quarter of 2008 and thus their share in total services exports has increased. This reflects the transformation of the Austrian economy towards more productivity in knowledge intensive sectors.

6.3 Regional structure of trade in services

The EU-15 region still remains the main target region for Austrian exports in services. The primary trade partners are Austria's neighbouring countries, with Germany being the main partner for Austrian exports (€ 15.8 billion in 2008, a 4.7 percent increase compared to 2007) and imports (€ 8.5 billion). The balance with Italy in 2008 was almost even (€ +0.3 billion) and exports to Switzerland increased to € 2.7 billion. The most important EU-12 countries for services exports as well as imports are the neighbouring countries Hungary and Czech Republic.

An analysis of the two most important regions for Austrian trade (EU-12 and EU-15) gives a somewhat different picture regarding export specialisation. In exports to the EU-15 the main positions are the travel sector (43 percent of total exports to EU-15 in 2008) as well as transport services (23 percent in 2008) and other business services (21 percent in 2008, with the major categories being merchanting services and research and development services).

Despite the fact that travel is the second most important category of services exports to the EU-12 countries after other business services, its share in total services exports in 2008 was just 27.4 percent. The share of KIBS in total services exports has grown over time, and came to 16.5 percent in 2008 (€ 1 billion). Even since the onset of the economic crisis in 2008, this position in the EU-12 region has increased (+21 percent) compared to 2007, while in the EU-15 countries a strong decrease can be noticed (–6.5 percent compared to last year).

6.4 Focus: trade in financial and insurance services

Since its accession to the EU in 1995, Austria has been characterised predominantly by a surplus in the financial services sector. Financial and insurance services (€ 2 billion) comprised 4.4 percent of total services exports in 2008. This represents a decrease in export volume of 8.1 percent compared to 2007. Financial and insurance services showed a positive balance of € 664 million in 2008. In consequence of the economic crisis, the export position of Austria, in both the financial and the insurance services, weakened in the first quarter of 2009 (–22.2 percent and –12.7 percent, respectively, in comparison to the first quarter of 2008).

The main target regions for Austrian services exports are the EU-15 and the EU-12. In 2008, nearly 70 percent of Austrian exports in the financial and insurance sector went to the EU-27.

6.5 Tourism

Egon Smeral (WIFO)

After growth amounting to a good +6% in 2007, world tourism – measured in terms of international tourist arrivals – expanded by only 2% in 2008. Having achieved healthy growth in the first half of that year, international tourist arrivals decreased by 0.5 percent and 2.5 percent respectively in the third and fourth quarters of 2008 as a result of the quickly spreading economic and financial market crisis.

Austria registered 21.9 million arrivals of foreign visitors in 2008; this corresponds to an increase of 5.6 percent compared to 2007. Revenue from international tourism (tourism exports) amounted to € 16.5 billion (+6.6 percent, or +3.2 percent in real terms, including international transport of passengers). Thus, Austria was able to gain additional market shares in international tourist travel for the first time since 2005.

Until December 2008, only partial effects of the economic and financial crisis were observable in Austria. Despite continuously worsening macroeconomic conditions, the situation of Austria's tourism industry is assessed as having being quite satisfactory up to that time.

In the calendar year 2008, Austria's tourism industry achieved turnover growth of 6.1 percent, due mainly to the good winter season 2007/2008 (+7 percent) and an unexpectedly successful summer season 2008 (+6.3 percent).

The first clearly observable effects of the economic and financial crisis on Austrian tourism appeared at the beginning of 2009, as international demand weakened considerably. From January to August 2009, the number of overnight stays of foreign visitors dropped by 3.5 percent compared to the same period in the previous year; in contrast, the domestic demand for overnight stays in Austria rose slightly (+1 percent).

As an annual average for 2009, the total turnover from tourism is expected to contract by approximately 4.5 percent; in 2010 a stagnation is expected.

7. Austrian foreign direct investment

Mariya Hake (WIFO), Susanne Sieber (WIFO)

7.1 Austria's position in international comparison

Due to the impacts of the global economic crisis, the ongoing growth in foreign direct investment (FDI) flows of the last years was interrupted. Worldwide as well as Austrian direct investment flows decreased in 2008 compared to the previous year. Nevertheless, Austrian outward flows still reached € 20 billion in 2008; inward flows to Austria amounted to € 9.5 billion. For 2009, FDI flows are expected to be low. Austrian FDI stocks still showed positive development in 2007, with both inward and outward FDI stocks reaching new record levels (€ 102.6 billion, € 108.1 billion).

The share of Austrian outward foreign direct investment stocks in total worldwide FDI stocks continued to increase in 2007 (table 7.1). Additionally, the ratio of Austrian outward foreign direct investment (FDI) stocks to its GDP, a measure of a country's degree of internationalisation, shows a continuous increase over time. In 2008 this Austrian outward foreign direct investment quota (36.6 percent) was four times as high as in 1998 (8.2 percent). However, the Austrian direct investment ratio in 2008 was still below the average of the EU-27 countries (44.4 percent), although above the average rate in industrialised countries (26.4 percent).

7.2 Austrian outward foreign direct investment

Austrian outward FDI stocks are characterised by a strong focus on Europe; 90 percent of all Austrian stocks are invested in that region. Although Germany is the main individual target country, the major target region is the Central and Eastern European countries (CEEC); in 2007, nearly 50 percent of all Austrian outward FDI stocks were invested in that region. Austria's strong position in the CEEC is also confirmed by the following: Austria was the most important foreign investor in five CEE countries (Slovenia, Bosnia and Herzegovina, Croatia, Romania and Bulgaria), and ranked third in the three neighbouring countries Slovakia, Hungary and the Czech Republic. Austria achieved a market share of 8.3 percent of total FDI stocks in the CEEC-5 and 6.2 percent in the CEEC-21, extraordinarily high percentages compared to Austria's market share in total worldwide inward FDI stocks, which amounted to just 0.8 percent in 2007. Adjusted for the country size by standardised market shares, Austria also exhibits a strong position compared to Germany, Italy, Switzerland or the Netherlands.

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

	Outward flows			Outward stocks		
	World	Austria	Austria	World	Austria[1])	Austria[1])
	Billion €		Percentage shares	Billion €		Percentage shares
2000	1,318	6.0	0.45	6,520	26.7	0.41
2001	833	3.4	0.41	7,373	32.4	0.44
2002	570	6.1	1.08	6,930	40.5	0.58
2003	499	6.1	1.22	6,843	44.3	0.65
2004	749	6.5	0.86	7,411	51.3	0.69
2005	707	9.1	1.27	8,986	60.9	0.68
2006	1,114	10.9	0.98	9,836	80.3	0.82
2007	1,568	28.5	1.82	11,023	102.6	0.93
2008	1,268	20.0	1.58	11,642	112	0.96
	Inward flows			**Inward stocks**		
	World	Austria	Austria	World	Austria[1])	Austria[1])
	Billion €		Percentage shares	Billion €		Percentage shares
2000	1,500	9.2	0.62	6,184	33.59	0.54
2001	917	6.4	0.69	6,958	39.7	0.57
2002	669	0.2	0.02	6,425	42.8	0.67
2003	501	5.5	1.10	6,461	45.6	0.71
2004	592	2.6	0.43	7,054	51.9	0.74
2005	782	8.7	1.11	8,518	70.0	0.82
2006	1,165	6.3	0.54	9,419	84.3	0.90
2007	1,445	22.8	1.57	10,639	108.1	1.02
2008	1,159	9.5	0.82	10,711	116	1.08

Source: Values for the world: UNCTAD, World Investment Report 2009; values for Austria: OeNB. – Due to statistical discrepancies worldwide outward FDI flows are not equal to worldwide inward FDI flows. – [1]) Austrian FDI stocks 2008: forecast according to *OeNB* (2009).

Employment in Austrian subsidiaries in foreign countries rose significantly in 2007, reaching 573,268 persons (weighted by share in voting capital). With respect to the sectoral structure, investments in the service sector (75.9 percent of total investments) dominated Austrian outward FDI stocks. Within the stocks in service sectors, the highest shares were reached in the financial and insurance sector, the real estate and business services sector (which also includes foreign direct investments in holding companies), and in the merchanting and other trade-related services sectors. Austrian outward investments again reached a remarkable record in profitability in 2007. Investments in the CEEC contributed substantially to that excellent result; more than half of the total net income for the year 2007 (€ 9.7 billion) was gained in the CEEC-21.

7.3 Austrian inward foreign direct investment

In contrast to Austrian outward foreign direct investment, the EU-15 is still the leading source region (63.8 percent) for inward FDI stocks. Although Germany is still the most important investor country, its shares in total inward foreign direct investment stocks decreased compared to 2002. One reason for this decline was the ownership change of Bank Austria from the German HypoVereinsbank to the Italian UniCredit. In 2007, Italian investments reached a share of 21.6 percent in total Austrian inward FDI stocks. Also remarkable is the sharp increase of FDI stocks from Russia, whose value in 2007 (€ 3 billion) was six times as high as in 2006 (€ 461 million). The number of people working in foreign subsidiaries in Austria (weighted by share in voting capital) decreased by 2,200 to 235,100 persons in 2007. The sectoral structure of Austrian inward foreign direct investment is difficult to interpret due to the fact that almost half of all stocks are invested in holding companies (*Dell'mour*, 2009)[7]). The new foreign affiliates statistics (FATS) give insights into the importance of foreign-controlled firms for the Austrian economy. Within the market-oriented sector, these foreign-controlled firms produced a quarter of the gross value added, and 19 percent of total employment of this sector can be allocated to firms with a foreign owner.

8. Specialisation and competitiveness of Austrian trade

Susanne Sieber (WIFO)

8.1 Importance of sophisticated sectors, specialisation and Austrian export market shares

Due to important challenges for the Austrian economy – especially the need to move from a middle technology position to the technological frontier – structural change towards more future-oriented industries appears desirable. Austrian manufacturing exports are still concentrated on mainstream industries, partly due to the high importance of machinery industries. The share of exports of technology-driven industries in total manufacturing exports amounted to 23.6 per-

[7]) Dell'mour, R, "Direktinvestitionen durchbrechen die Schallmauer von 100 Mrd EUR", Statistiken – Daten und Analysen, OeNB, 2009, (Q3/09).

cent in 2008, which is lower than in typical reference countries such as Germany, Sweden or Switzerland. Moreover, the figures for 2008 show no comparative advantage of Austrian technology-driven exports, in contrast to the results for the above-mentioned three reference countries. Comparative advantages are measured by the so-called revealed comparative advantage (RCA) indicator, which is defined as the logarithm of the export to import relation of one sector divided by the export to import relation of the sum of all exports. Positive values are therefore interpreted as comparative advantages, negative values as comparative disadvantages.

However, Austrian exports from industries dominated by quality competition, as well as from industries with high qualification requirements on the human capital used, show a comparative advantage in 2008. Their shares in total Austrian manufacturing exports amount to 47.4 percent and 23.2 percent, respectively. In both of these sophisticated industry types, Austrian exports were able to achieve above-average market shares. The most important sophisticated industries in Austrian exports are the exports of automobiles and engines, pharmaceutical products, and various machinery-producing industries. Exports of motor vehicles amounted to € 9.5 billion in 2008, which corresponds to a share in total manufacturing exports of 9.1 percent. Pharmaceuticals reached € 5 billion or a share of 4.9 percent in 2008. Austrian exports from both of these sectors show a comparative advantage. A comparison of the figures for 2008 and 2003 shows that the trade balance of total Austrian manufacturing exports has improved. The trade balance of industries dominated by intensive quality competition clearly contributed to this improvement by € 6 billion. Within the group of industries characterised by high qualification requirements on the human capital used, the trade balance also showed an improvement between 2003 and 2008; the same applies to the group of technology-intensive industries.

8.2 Intra-industry trade with CEEC-10

Intra-industry trade can be defined as two-way trade of differentiated goods of the same product category. According to the literature, more intra-industry trade would be expected between two countries with similar per capita incomes. Therefore, it is not surprising that the absolute level of intra-industry trade with the 10 new Central and Eastern European countries (CEEC-10) lies below the level of intra-industry trade with the EU-15. Within Austrian trade with CEEC-10, the share of intra-industry trade was highest in exchange with the three neighbouring countries Czech Republic, Slovakia and Hungary. It was lowest in trade with the three Baltic States.

Table 8.1: Austrian foreign trade performance in comparison with Germany, Sweden and Switzerland

2008

	Austria			Germany		
	Trade balance	RCA value	Export world market share	Trade balance	RCA value	Export world market share
	Million €		Percent	Million €		Percent
Factors of production						
Mainstream	7,459	0.186	2.33	118,275	0.280	17.07
Labour intensive	1,387	0.030	2.05	12,099	– 0.239	11.39
Capital intensive	– 1,979	– 0.170	1.41	28,358	– 0.225	12.06
Marketing driven	551	– 0.033	1.74	14,823	– 0.211	10.65
Technology driven	114	– 0.070	1.22	118,716	0.086	15.09
Human capital						
Low skill	– 251	– 0.083	1.73	11,036	– 0.344	10.36
Medium skill/blue c.w.	4,894	0.109	2.19	115,022	0.258	17.77
Medium skill/white c.w.	– 1,993	– 0.163	1.17	67,458	– 0.067	12.50
High skill	4,880	0.150	1.76	98,755	0.166	16.42
Quality competition						
Low RQE	787	– 0.049	1.61	29,265	– 0.261	11.14
Medium RQE	414	– 0.058	1.57	43,819	– 0.142	12.25
High RQE	6,329	0.062	1.75	219,187	0.218	16.65
Manufacturing	7,531	–	1.66	292,271	–	13.90

	Sweden			Switzerland		
	Trade balance	RCA value	Export world market share	Trade balance	RCA value	Export world market share
	Million €		Percent	Million €		Percent
Factors of production						
Mainstream	4,749	0.054	1.86	4,111	– 0.021	1.88
Labour intensive	1,178	– 0.032	1.58	– 2,550	– 0.353	2.16
Capital intensive	5,215	0.067	1.92	– 2,334	– 0.321	1.21
Marketing driven	– 4,071	– 0.614	0.88	6,667	0.219	2.55
Technology driven	6,607	0.114	1.42	16,698	0.201	2.55
Human capital						
Low skill	– 4,030	– 0.330	1.20	– 8,399	– 0.572	1.07
Medium skill/blue c.w.	5,084	0.080	1.87	– 9,607	– 0.736	1.00
Medium skill/white c.w.	5,441	0.052	1.60	15,184	0.226	2.38
High skill	7,185	0.209	1.74	25,414	0.461	3.85
Quality competition						
Low RQE	7,682	0.100	1.82	– 5,864	– 0.405	1.30
Medium RQE	– 4,394	– 0.353	1.27	– 4,781	– 0.438	1.12
High RQE	10,391	0.116	1.58	33,238	0.289	3.07
Manufacturing	13,679	–	1.58	22,592	–	2.06

Source: UNO, Statistics Austria, WIFO calculations. – Classification of industries according to *Peneder* (2001) and *Aiginger* (2000). RQE = Revealed Quality Elasticity.

8.3 Regional diversification

Although the degree of internationalisation increased in Austrian foreign trade, especially through the growing importance of Central and Eastern Europe for Austrian trade, regional diversification is still low compared to other European countries. This is due to the ongoing high concentration on Europe; 83.5 percent of all Austrian exports in goods are still sent to Europe, and 54.1 percent of the goods are still exported to one of the eight neighbouring countries. According to the Herfindahl index provided by the UN International Trade Statistics Yearbook 2008 – which measures regional concentration – Austria shows a below-average result compared to other EU-15 countries.

Special Topic: New Protectionism – A Threat to World Trade?

9. Free trade and protectionism – theoretical arguments and current measures by the EU, the USA and China

Johannes Pöschl (wiiw)

9.1 Introduction

After a long upward trend, there has been sharp contraction of world trade due to the global recession. Trade volumes worldwide are likely to drop by 10 percent in 2009, whereas foreign direct investment will be hit even harder, with a global downturn of 30 percent to 40 percent.

Although the G-20 agreed on continuing the promotion of free trade in November 2009, there has been a rise in protectionism since then. Under the GATT agreement, there is only a limited possibility of raising tariffs for WTO members, but there has been a significant rise in bail-out programmes and export subsidies. Protectionist measures such as anti-dumping, countervailing duties and safeguards have also been used more excessively during the last year.

9.2 Free trade vs. protectionist measures

According to Ricardo's theory of comparative advantages, trade leads to a specialisation of countries in the products they can produce relatively more cost-efficiently because of geographical, institutional or social differences. Other arguments for free trade include increased competition, technology spillover effects and ecological advantages. The reallocation of resources due to free trade leads to a general welfare gain but may create winners and losers within the country. Sectoral and social restructuring processes are therefore one of the great challenges of trade liberalisation.

Due to these restructuring processes, almost all countries have excessively used protectionist measures at earlier stages of their development. Import-restricting measures such as tariffs and quotas in general lead to welfare losses because factors of production are not efficiently used. Apart from the allocation argument, there might be dynamic effects that support the application of protectionist measures. One prominent example is the infant-industry argument which states that emerging industries might need to be protected until they have reached the scale effects and efficiency ("learning-by-doing") of their international rivals. Another argument for protectionist measures is technical barriers to trade.

Most of the industrialised countries have switched from an import-restricting to an export-supporting policy. When deciding upon export subsidies, there is always a danger of a subsidy war, which is characterised by welfare losses in the implementing countries. In order to protect home industries from underpriced import goods, the WTO members are allowed to impose countervailing duties or to use anti-dumping measures. Another measure being used more frequently recently is safeguards, which can be used by countries if their domestic industry is injured by a surge in imports.

9.3 Current measures by the EU, the USA and China

The requests for protectionist measures within the WTO rose by 18.5 percent in the first half of 2009 compared to the same period in 2008. After a boom in anti-dumping measures at the beginning of the crisis, a rise in the number of safeguards has now been observable, which is mostly attributable to requests in India.

The country most affected by newly imposed measures is, by far, China. In 12 of the 17 approved measures, China is the only targeted country. This is possible due to China's special status within the WTO, which accrues from China's incomplete transformation to a market economy and the continuing heavy state inventions. This status allows other countries to deviate from the most-favoured-nation treatment and initiate China-specific safeguards.

When looking at industries, the typical pattern emerges, namely that the industries demanding most in the way of protectionist measures have been the usual suspects food products, steel and chemicals.

However, a number of liberalising steps have also been undertaken by many countries. From the end of 2008 until March 2009, 28 liberalisation steps were reported, as compared to 68 protectionist measures. All things considered, the rise in trade protectionism does not seem more pronounced than in former recent crises.

A positive signal has come, as well, from the G-20 summit in Pittsburgh, where, in their statement, the leaders agreed on continuing negotiations within the Doha Development Round, which collapsed in 2008 over issues of agricultural trade between the United States and India. One may hope that this is more than a signal in the right direction.

10. Government influence on the economy and global open markets

Roman Stöllinger (wiiw)

10.1 Introduction

Governments in industrialised countries by and large have refrained from erecting new tariff walls and other "at the border" measures since the outbreak of the global economic crisis. Nevertheless, discrimination against foreign firms through measures taken in the framework of the fiscal stimulus packages to fight the crisis is discernible in several areas. These include bail-outs and support measures for the banking system but also subsidies to other industries (notably the car industry) and public procurement. Both subsidies and public procurement have gained importance because of the magnitude of public investment programmes and public support schemes for industries hit by the crisis. These kinds of interventions are rarely neutral with regard to a system of fair and transparent competition on open markets, to which the leaders of the G-20 have committed themselves.

10.2 State interventions in the financial sector

The systemic bail-outs of banks by governments in the USA, the euro area, the United Kingdom and elsewhere were undoubtedly helpful in avoiding a broader collapse of the global financial system. Therefore, these interventions seem justifiable since the stabilisation of financial markets in times of crisis may be seen as a public good. The fact that the bank bail-outs were organised by national governments for institutes domiciled in their domestic markets implies, however, that they also have distortive effects on competition. In several instances, the support measures for banks, including those in the United Kingdom, were coupled with instructions by the respective government to give priority to the domestic credit supply. This constitutes a particular form of financial protectionism with potentially high impact, given the fact that the sums involved were gigantic and that several major banks became highly depend on government assistance.

It is a fact that international credit operations have drastically declined since mid-2008. While banks tend to have a commercially driven home market bias, which strengthens during times of crisis, the insistence of national governments on giving preference to the domestic credit markets most likely reinforced the drop in international credit flows. Even within the monetarily integrated euro area, the crisis seems to have changed banks' behaviour. Until the end of 2007, their claims against the private sector in their countries of residence grew at a much lower rate than claims against the private sector in the rest of the euro area as banks internationalised their operations. But with the onset of the financial crisis, this trend reversed. This gives support to the hypothesis that governments (via both formal rules and informal arrangements and political pressure) influenced banks' lending strategies very much in favour of extending credit to domestic customers. Hence, the bail-outs and other government support measures are likely to have contributed to the fragmentation of financial markets during the crisis.

10.3 Firm subsidies and fair competition on global markets

State support and bail-outs were not limited to the financial sector. Next in line to receive large government subsidies was the car industry. So far, there are no signs of an all-out subsidy war, but the car industry nevertheless may have set the example.

International obligations of major trading nations, in particular the WTO Agreement on Subsidies and Countervailing Measures (ASCM), may prove insufficient as a shield against the rise of subsidies. One reason is that WTO members are very reluctant to initiate a WTO case if they are handing out heavy subsidies themselves. For example, the European Commission quickly dropped the idea of challenging the US subsidies for General Motors and Chrysler at the WTO when it became apparent that the European car industry required support as well. In the meantime, Germany, France, the United Kingdom, Sweden, Italy and Spain granted additional subsidies in various forms to their major car manufacturers. In December 2008, the European Commission relaxed EU rules on state aid by adopting the "Temporary framework for State aid measures to support access to finance in the current financial and economic crisis" (Temporary Framework). The Temporary Framework (in force until the end of 2010) allows, inter alia, grants up to € 500,000 for individual companies as well as subsidised loans and guarantees. The intention of the new state aid flexibilities is to support fundamentally sound companies in mastering crisis-related difficulties, in particular restricted access to finance. However, the Global Trade Alert, an independent initiative that monitors economic policy measures, classified all but one of the state aid schemes notified by EU member states (and cleared by the European Commission) under the Temporary Framework as discriminatory[8]).

[8]) Up to 9 September 2009, the European Commission approved more than 50 state aid schemes by member states under the Temporary Framework. Only ten are registered at the Global Trade Alert database, but nine of these aid schemes were classified red (discriminatory) and one was classified orange (possibly discriminatory). None was classified green (non-discriminatory).

10.4 Public procurement as a protectionist tool

The fiscal stimulus packages of major industrialised economies also increased the role of public procurement, since investment programmes form a major part of many of these packages. Public procurement is a prime domain for favouring domestic companies over foreign competitors. Changes to public procurement provisions emerge as a popular policy tool for tilting the level playing field in favour of domestic firms, accounting for 6 percent of all implemented measures registered by the Global Trade Alert since the first meeting of the G-20. The majority of these measures (75 percent) were classified discriminatory. They include clear examples of discrimination such as buy-national clauses first implemented by the USA, but also more subtle measures such as France's move to increase the threshold value for public contract requiring a public tender (up to the maximum value allowed under EU law).

Experiences in the area of official development assistance (ODA) also demonstrate that governments use public contracts for the promotion of domestic firms. OECD donor countries still tie 20 percent of their development aid to the provision of goods from their own country (2006 figures), despite strong evidence that this practice undermines the effectiveness of aid. Moreover, even if development aid is provided untied, domestic firms emerge conspicuously often as the bid winners of the tender process. For Australia, the share of projects awarded to domestic firms is 100 percent, for the United Kingdom and the USA the share is 84 percent (2005 figures). A similar bias can be expected to exist in the public investment programmes that form part of the stimulus packages, regardless of whether the discrimination against foreign firms is formally laid down in regulations or not.

10.5 Conclusions

Despite the likely positive effects of the fiscal stimulus packages on economic recovery, their trade-distorting effects should not be neglected. Protectionist tendencies can be detected in the financial sector bailouts, in state aid schemes for other crisis-stricken industries and in public procurement. Some authors, such as Frederic Erixon, have pointed out that it is an illusion to think that Keynesian fiscal policy can be conducted at the national level without interfering with Smithian principles of free trade. The conclusion to be drawn here is that the current situation is a manifestation of what Rodrik termed the political "trilemma of the global economy". This trilemma refers the area of conflict between the nation state system, democratic politics and deep economic integration. Since taxpayers – voters and firms alike – have a legitimate interest in reaping the maximum benefit of the national support measure which they must finance (equivalence principle), there will be political pressure to use subsidies and public contracts to save domestic firms and jobs at home. This, however, implies protectionism, which causes difficulties for a deeply integrated global trading system. Presumably, expectations about free and open international competition on international markets have to be scaled down for the time of the crisis.

11. Trade liberalisation versus trade protectionism in times of economic recession

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

With global recession bottoming out and international trade about to pick up in some countries, global demand is still weak and unemployment is going to rise at least until the end of 2010. According to ILO estimates, unemployment will increase by 40 to 50 million as a consequence of the world crisis. These facts are ignored by the commitment of the G-20 countries to resisting trade protectionist measures and furthering trade liberalisation through a swift conclusion of the Doha round. Although the monitoring reports of the WTO, the OECD and UNCTAD show no new protectionist tendencies as a general policy of the G-20 to tackle the crisis, some countries will be compelled to make use of trade restrictive measures because of the persistent pressure to open up their markets.

Experiences of the last thirty years in Africa and Latin America, but also assessment studies of the ongoing Doha negotiations, show that trade liberalisation and the linked strategy of market access have the potential to destroy entire industries, thereby creating further unemployment. Liberalisation in times of growing unemployment due to the global economic crisis will aggravate the pressure on the labour market even more. As a consequence, the pressure for trade liberalisation could lead to its contrary: it could provoke further trade restrictions.

12. The importance of non-tariff barriers in the crisis

Harald Past (Austrian Federal Economic Chamber)

World trade volume decreased dramatically in the first quarter of 2009. A sustainable recovery is not yet within reach. Even though it may seem paradoxical, some voices are calling for the imposition of protectionist measures, which would lead to an even deeper reduction in trade volumes.

The European Commission and the World Trade Organization have already monitored several trade-disruptive measures implemented by trade partners, mainly on a non-tariff basis. The measures range from discrimination of foreign tenderers in public procurement to buy-local initiatives in the context of economic stimulus packages.

The Global Trade Alert report, masterminded by the Centre for Economic Policy Research (CEPR), reveals that only 15 percent of trade-distortive measures implemented since December 2008 are related to tariff measures. The vast majority of trade-distortive measures concern actions on a non-tariff basis, headed by bail-out and state aid measures.

Given that existing WTO regulations limit the opportunities of member states to raise tariffs, some member states have tried to protect their economies by introducing non-tariff measures. Studies show that NTBs can have a more negative impact on trade relations than tariffs.

Although the situation has improved over the last years, there is still much research left for economists to do to expose the aftermath of non-tariff trade barriers on economies and world trade development, and methodological problems regarding the determination of NTBs still remain.

It is too early to draw a conclusion regarding the influence of the imposed measures on trade volumes. However, there is no doubt that especially for an export-oriented economy such as Austria's, a good trade policy framework is necessary for economic recovery. A recent study for Austria shows that a growth in exports of € 1 million leads to additional added value of € 1.4 million[9]). For exports in services, this multiplier is even higher.

13. Two World Economic Crises – A Comparison

Franz Nauschnigg (OeNB)

What started as a financial crisis in the US real estate sector (sub-prime crisis) in mid-2007 has developed into a worldwide financial and economic crisis. Early hopes of decoupling Europe and Asia from the crisis in the USA were not fulfilled, as the crisis spread internationally through liquidity and banking crises, falling trade, capital flows, as well as falling bond, real estate and raw material prices.

[9]) Fritz, O., Hierländer, R., Bayerl, N., Streicher, G., Exports, Services and Value Added - A National, International and Regional Analysis for Austria, FIW Study, 2008, (008).

The current crisis is the worst global financial and economic crisis since the Great Depression in the 1930s. The Great Depression also started in the USA with a stock market crash which led to falling trade, capital flows and raw material prices worldwide. The slumps we have recently witnessed worldwide equal those of the Great Depression (stock market prices, industrial production) or are even of a larger scale (world trade).

Decisive economic policy action has been taken to address the current crisis; in particular, the monetary and fiscal policies pursued have been strongly counter-cyclical. Central banks quickly lowered interest rates to almost zero, provided the financial system with sufficient liquidity, and took non-conventional measures.

Fiscal policy was also strongly counter-cyclical and budget deficits were increased substantially, as proposed by Keynes to support domestic demand during downturns.

In the Great Depression, by contrast, central banks defended their currencies' exchange rates under the gold standard and did not lower interest rates significantly. Also, fiscal policies were not used to actively counter the crisis (no strong deficit spending to support domestic demand).

A central feature of the current crisis has been that international cooperation – in particular within the framework of the G-20, the EU and the IMF – has been strengthened to support financial systems and states. Especially Central, Eastern and South Eastern Europe and countries with large exposures to this region, such as Austria, have benefited from this concerted action.

In the Great Depression, by contrast, international cooperation suffered while protectionism and nationalism became stronger, leading, ultimately, to the Second World War. It was only in 1944 that the Bretton Woods System was created. Keynes had found that the Great Depression had its roots in the imperfections of the monetary and financial system. The Bretton Woods System regulated many parts of the economy, assigning a strong role to the state, and was quite successful, with few financial crises occurring until its breakdown in 1971.

What followed afterwards was a trend of deregulation and privatisation under the neo-liberal paradigm. Market elements were incorporated even into financial regulation (Basel II) and accounting rules (mark-to-market), providing for strong pro-cyclical effects. Large parts of the financial system were left without proper supervision. The number of financial crises increased dramatically.

Only in the recent crisis has the state been reassigned a more important role. Economic policy measures have helped to overcome the crisis and the IMF forecasts that the global recession is ending. After shrinking by 1 percent in 2009, the global economy is expected to grow by 3 percent in 2010.

Bundesministerium für
Wirtschaft, Familie und Jugend

FIW – a collaboration of WIFO – wiiw – WSR in the framework of the Austrian Federal Government's "Internationalisation Drive"