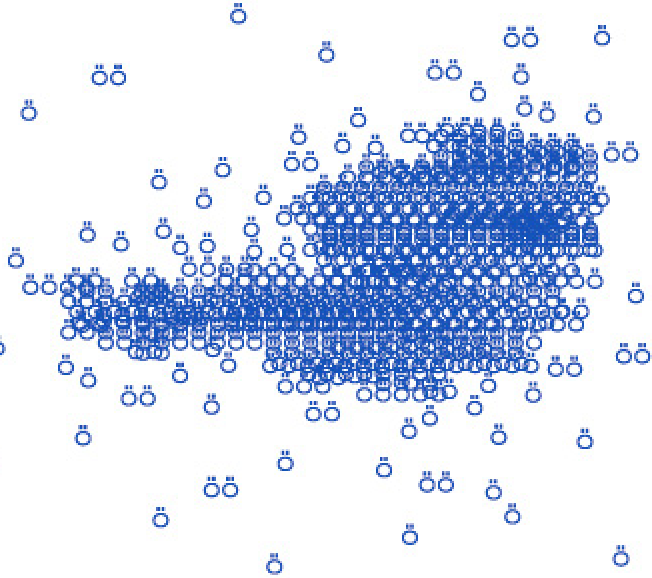
Austria's External Economic Relations 2007



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Contents

Global Economy

1. Trends and challenges in the global economy

Michael Landesmann (wiiw)

In this introductory chapter we comment on some selected aspects of global economic developments. We start with a discussion of important current macroeconomic trends, with a focus on built-up external disequilibria followed by an assessment of the course and the impact of "re-equilibration" processes which have started to unfold over the past year. We then move on to a description of important (longer-term) structural features of current trends in global economic integration together with a short review of recent developments in international economics which can be used to understand such features. We emphasize in particular that following a longer phase of "North-North integration" after World War II (when international economic relations were dominated by trade and investment integration between advanced economies) we now find ourselves – again – in a phase of intensified "South-North integration" which is shaped by the dynamic entry of significant groups of catching-up economies into global economic structures. The adjustment processes characterizing this new phase of South-North integration represent – in our view – the most dynamic of changes in global economic structures and also some of the most important policy challenges.

2. Global economic and institutional environment

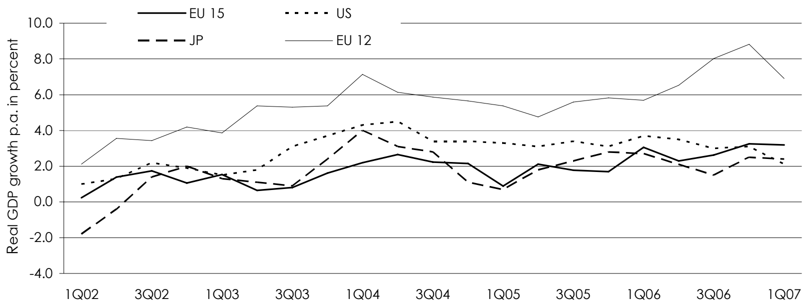
Julia Wörz (wiiw)

2.1 Global upswing despite high price volatility

The global expansion of economic output reached a peak in 2006 with a real growth rate of world GDP estimated at around 4 percent (World Bank; IMF: 3.9 percent). Since then, a downturn in the US economy has been observed, which began in the second half of 2006, while economic activity in the Euro area (in particular in Germany and Italy) has accelerated over the same period. The outstandingly high global growth rates were strongly influenced by extremely fast-growing emerging economies in countries such as China, India, Russia and Turkey. The stable and favourable economic environment within the OECD area can be read from Figure 2.1. The acceleration in growth in countries like Germany is based on robust investment, a notable improvement of the labour market situation and the resulting recovery of domestic demand. Due to increasing reliance on domestic demand, which has also been observed in many emerging markets, the weakening US economy is not expected to have a strong and immediate impact on the global environment.

Figure 2.1: Economic activity in main OECD regions

2002 to 2007



Source: Eurostat, OECD, Economic Outlook.

Despite the slowdown in the first quarter of 2007 and the housing and credit market shock in the USA, which was initiated by the bursting of the bubble in house prices in early August of 2007, the expectations for 2007 and 2008 remain positive overall. The weakening in US demand will result in a slight decrease in global growth rates compared to 2006; the most recent forecast by the IMF (of October 2007) predicts 3.5 percent real growth globally for 2007 and 3.3 percent for 2008. This is not too far from earlier estimations by the World Bank (3.3 percent for 2007 and 3.6 percent for 2008).

Risks to this favourable outlook, which is again very much supported by strong growth in developing and emerging countries, arise mainly from three factors. First, historically high and very volatile commodity prices are expected to prevail throughout the next few years. The strengthening of domestic demand further implies that high oil prices will impact more strongly on the economy than in the past two years.

Second, developments in international financial markets are difficult to assess at the moment. Financial assets are still frequently overpriced (or risks are undervalued) despite the corrections that have begun since the US house market crash in August of 2007. To date, the sound economic foundations of the US economy – a flexible labour market, good demographic trends, its innovative ability and also the rather cautious monetary policy of the central bank – have prevented the crisis from having more severe international repercussions. From this perspective, the crisis can be seen as a long overdue, necessary correction of existing imbalances. Finally, the existing large and globally persistent current account imbalances represent a potential downside risk to global growth over the next years. The US current account deficit has been hovering at around 6 percent for years, and so far the weakening of domestic demand has resulted in only very modest reductions. In contrast, oil-exporting emerging countries as well as Japan and China have been running large surpluses for years; China's current account surplus is not projected to fall below 10 percent in the near future. The major exchange rates show no sign of moving in the direction of correcting these imbalances, because China's monetary policy has prevented a weakening of the dollar towards the Yuan.

As aforementioned, the robust global growth prospects are being strongly influenced by dynamic developments in most emerging markets. China, being now the world's third-largest trading nation, is expected to continue to show grow rates in real GDP of more than 10 percent until 2008, a development which is based on high investment growth, an increasing trade surplus and a slight acceleration in consumption. Private consumption and high investments were also at the heart of Russia's unexpectedly high growth rates of 6.9 percent in 2006 and an estimated 5.2 percent for 2007. A restrictive monetary policy stabilised the Turkish economy; however, despite weakening domestic demand, growth was sustained at 7.4 percent in 2006 by robust export demand. A slight moderation towards 5.7 percent and 6.2 percent is expected for 2007 and 2008.

2.2 The institutional global environment

2.2.1 Multilateral trade negotiations (WTO)

The status of multilateral trade negotiations is difficult to define at the moment. The current round of WTO negotiations, which started in 2001 in Doha, was suspended for the second half of 2006 after the last ministerial meeting in December 2005 in Hong Kong as well as two consecutive meetings in Geneva in June and July 2006 ended without any result. In June 2007, an attempt to revive the negotiations through a meeting of the "group of four" (EU, USA, India and Brazil) was unsuccessful. Moreover, the draft documents provided by the chairpersons of the negotiating groups on agriculture and NAMA (non-agricultural market access) could not bring an advancement of the round, since the single-undertaking approach makes it impossible to codify individual agreements. Nevertheless, the draft text by the chairman of the negotiating group on agriculture brought about some progress since it explicitly mentions upper bounds for support measures. On the other hand, the draft text of the NAMA group (non-agricultural market access) could not bridge the differences between members with low average tariffs and those with high average tariffs, and no further progress was made in other parts of the negotiations.

With the accession of Vietnam and Tonga in 2007, the WTO now comprises 151 members. 26 accession negotiations are pending, among them negotiations with Russia, Ukraine, Serbia, and Montenegro.

2.2.2 Bilateral and regional negotiations

As a consequence of the standstill in multilateral negotiations, a number of bilateral activities have been pursued with increased efforts. In order not to fall behind the USA, the EU started negotiations with the Republic of Korea and ASEAN in May 2007, and it was decided that free trade negotiations with India were to be initiated. This marks a notable shift in EU trade policy, since the EU has been one of the most vigorous advocates of the multilateral approach to trade liberalisation. However, the EU maintains formal links containing free trade aspects with almost all regions in the world. Currently, so-called "Economic Partnership Agreements (EPAs)" are being negotiated with partners in the Mediterranean and in Africa. These agreements will replace the former Lomé and current Cotonou agreements with individual African regions, as those have been identified as being inconsistent with WTO rules. The EPAs require more opening to trade on the part of developing partners than previous agreements and have therefore been sharply criticised. The EU argues against this criticism by pointing out the beneficial effects arising from increased South-South trade relationships through these agreements. In Latin America, the EU started to negotiate association agreements containing free trade aspects with Columbia and Costa Rica in late 2007.

The USA completed negotiations on a free trade area with the Republic of Korea in April 2007, shortly before the fast-track authority of the president expired. Negotiations are also underway with other

Asian partners, such as Thailand and Malaysia. No progress has been seen in Pan-American free trade talks; since 2003 no negotiations have taken place. The dividing lines are similar to those which caused the standstill of the Doha Round: disagreement over agricultural subsidies on the one hand and over the inclusion of services and intellectual property rights in the agenda on the other hand. The main opponents within the FTAA are the largest economic powers, the USA and Brazil.

The integration in South America within Mercosur has been considerably more successful to date. Venezuela became the fifth full member in July 2006. The founding members are Brazil, Argentina, Paraguay and Uruguay, and association agreements have been concluded with Chile, Bolivia and Peru. Besides enlargement, some deepening of integration has also been achieved through the opening of a Mercosur parliament in May 2007 and the decision on the creation of an independent Bank of the South.

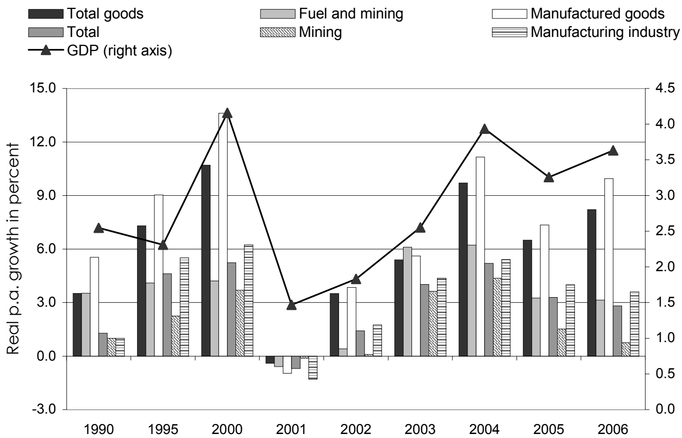
Asia has recently shown highly dynamic and successful integration efforts. 40 years of ASEAN were celebrated in 2007. A further deepening of regional integration can be read from the decision to shift the date for the formation of an ASEAN Economic Community (AEC) forward from 2020 to 2015. This economic community in intended to enable the free movement of goods, services and investment, similar to the Common Market within the EU, which serves as a model. Agreement has also been reached on an ASEAN Charta which will give legal status to ASEAN and promote the independence and authority of the ASEAN secretariat. Enlargement of ASEAN takes a particular form; the accession of new members is not foreseen in the current concept, but enlargement is intended to occur through the creation of a greater Asian free trade area by means of bilateral agreements with individual partners. For instance, an agreement to conclude a free trade area with China until 2010 is already in effect, the conclusion of negotiations with New Zealand can be expected soon, and Australia may follow shortly. Pre-negotiations with Japan have also been concluded successfully. The Republic of Korea and India are further candidates for free trade agreements. In contrast to ASEAN, the larger regional Asian forum APEC has always been an advocate of the multilateral approach to trade negotiations and consequently the 2007 annual APEC meeting in Sidney called for a successful completion of the Doha Round. In case of a failure at the WTO, an Asiatic-Pacific free trade area is envisaged between the 21 members of APEC.

3. Developments in world trade

Julia Wörz (wiiw)

Figure 3.1: Exports, production and global GDP, real growth

1990 to 2006



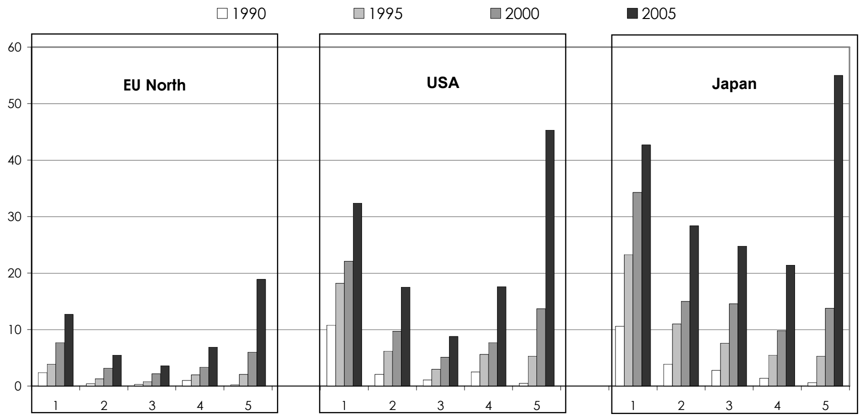
Source: WTO International Trade Statistics 2007.

Given the favourable economic environment, world trade, too, developed dynamically in 2006. This refers to all three components of world trade: the global exchange of goods, services, and especially international direct investments. The strong expansion of goods trade (in nominal but also in real terms) in 2006 reflects the fact that initially the recent economic upswing was strongly supported by external demand. The real growth rate of goods exports surpassed the real expansion in goods production, which implies an increase in the spread between the two growth rates. For 2007 this spread will be reduced again, following the stronger importance of domestic demand for economic growth in the Euro area as well as in many emerging markets. Trade in services expanded more in line with world GDP, and the ratio of services in total trade as measured by balance of payments data remained stable at around 20 percent. When considering all modes of delivery for trade in services (i.e., in particular mode 3, through local establishment) this ratio amounts to roughly 30 percent. The increase in global direct investment flows was very pronounced and again reached the record levels of 2000. In absolute terms, the value of global direct investment stocks is certainly comparable to the value of worldwide goods exports of $ 12,000 billion in 2006.

3.1 Global trade in goods

Figure 3.2: Import shares of China in EU North, USA and Japan

In percent



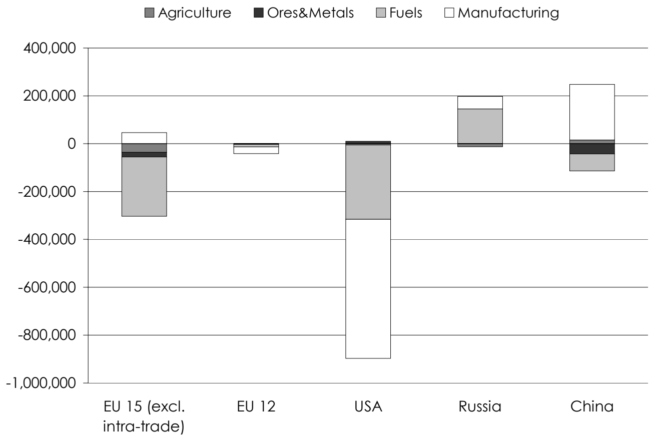
Technological content: 1: low tech, 2: medium-low tech, 3: medium-high tech, 4: high tech, 5: office machinery and computing equipment.

Source: wiiw-calculations.

Trade in goods is very much concentrated within and between the major trading blocks, that is, the EU, NAFTA and Asia. Intra-EU trade amounted to $ 2,800 billion in 2006, which is twice the value of Intra-Asian trade. Trade within NAFTA amounted to roughly $ 500 million in the same year. Apart from noticeable trade links between these three blocks, global trade integration remains surprisingly regionalised. The rising import penetration of China in the manufacturing sector of the triad EU-USA-Japan can clearly be seen from Figure 3.2. What is interesting to note is not only the sharp increases in import penetration in low-tech industries, but the even stronger increases in high-tech industries and, in particular, in office machinery and computing equipment. This reflects a successful catching-up on the part of China and – despite discussions of intellectual property right violations – a quality upgrading in Chinese production. However, also low-skill production of high-tech goods is responsible for the observed pattern. The much lower import penetration ratios in the EU as compared to Japan and the USA are a statistical artefact arising from the inclusion of intra-EU trade in the calculations.

Figure 3.3: Global trade balances 2006

Million $



Source: UN COMTRADE.

In part, this increasing import penetration of China is also reflected in widening global trade imbalances, as illustrated in Figure 3.3. The persistence of these imbalances is of major concern for the stability of economic prospects, as mentioned above. The huge trade deficit of the USA finds its counterparts in the great surplus of China and other fast-growing middle and low income Asian economies (not depicted in Figure 3.2). Due to mutually beneficial trade relations with the new EU members, the EU 15 maintained a surplus in manufacturing trade in 2006; outstandingly high oil prices explain the overall deficit here. China's relatively high trade deficit in ores, metals and fuels reflects the strong demand of the Chinese economy for commodities and energy and thus impacts in turn on these price developments.

A sectoral breakdown of global goods trade reveals no major changes over the past five years: Machinery and transport equipment account for the vast majority of traded goods. Due to price developments, raw materials have seen increases in their share in total trade, while textiles and agricultural products have been declining in relative terms. Chemical products have been increasingly gaining importance, representing more than 10 percent of global exports in 2006.

3.2 Global trade in services

Table 3.1: Leading exporters and importers in world trade in commercial services (excluding intra-EU (25) trade)

2006

Rank	Exporters	Value Billion $	Percentage share	Annual percentage change
1	Extra-EU (25) exports	555.4	27.3	12
2	United States	388.8	19.1	10
3	Japan	122.5	6.0	14
4	China	91.4	4.5	24
5	India	73.8	3.6	36
6	Hong Kong, China	72.7	3.6	14
7	Canada	57.7	2.8	7
8	Singapore	57.3	2.8	12
9	Switzerland	50.6	2.5	10
10	Korea, Republic of	50.4	2.5	15
11	Norway	32.7	1.6	12
12	Australia	32.4	1.6	7
13	Russian Federation	30.1	1.5	24
14	Taipei, Chinese	28.8	1.4	13
15	Thailand	23.9	1.2	19
	Importers			
1	Extra-EU (25) imports	471.7	24.0	10
2	United States	307.8	15.7	9
3	Japan	144.0	7.3	9
4	China	100.3	5.1	21
5	Canada	71.7	3.7	11
6	Korea, Republic of	69.8	3.6	20
7	India	63.7	3.2	29
8	Singapore	60.8	3.1	12
9	Russian Federation	44.3	2.3	15
10	Hong Kong, China	36.6	1.9	8
11	Taipei, Chinese	32.6	1.7	4
12	Thailand	31.8	1.6	18
13	Australia	31.6	1.6	6
14	Norway	30.6	1.6	6
15	Switzerland	28.8	1.5	10

Source: WTO, International Trade Statistics 2007.

Trade in services as measured by balance of payments data amounted to $ 2.7 billion in 2006, more than half of which constituted trade with other services, comprising commercial, personal and government services. Growth in this category was most dynamic as well. Within other services, about 50 percent constitute other business services; financial services are the second most important category

(8 percent), followed by computer and information services (5 percent).

Regionally, trade in services is even more concentrated in the economically well-integrated EU. About 50 percent of global service exports originate from the EU 25, while the same region accounts for "only" 40 percent of goods exports. Trade in services is thus much more concentrated regionally and it is also concentrated in fewer regions. The EU and the USA are the main trading blocks here; Asia plays a substantially smaller role in services trade as compared to goods trade. Nevertheless, China has already emerged as the fourth most important single exporter of services in 2006, after the EU 25 (excluding intra-trade), the USA and Japan (see Table 3.1).

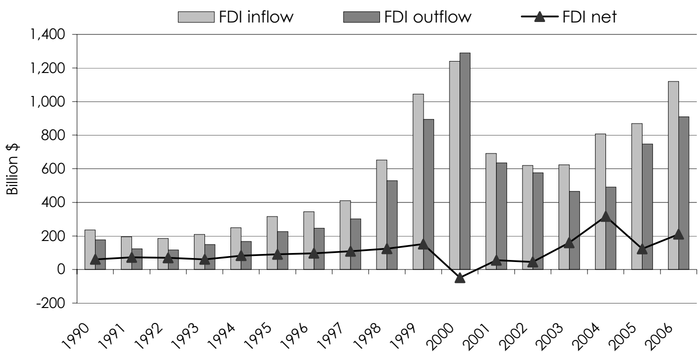
3.3 Global foreign direct investments

A range of factors benefited global foreign direct investment (FDI) flows in 2006: for instance, robust economic growth in most world regions, high corporate profits, relatively low interest rates and high asset and housing prices. Some of these factors have changed considerably during 2007; nevertheless, the notable increase in mergers and acquisitions during the first half of 2007 points towards a continued increase in global FDI in 2007. Industrialised countries still account for the vast majority of FDI flows, in terms of both source and destination countries. Over the past decade, the most important donors within the OECD have been the United Kingdom, France, Japan, Switzerland and Spain. This is caused by macroeconomic as well as structural factors. In the case of Japan, for instance, continued high current account surpluses necessitated outward investments. In contrast, diversification strategies of multination firms play a major role for Swiss outward investments. Finally, historical links (for instance with former colonies) add to the strong outward investment activities of countries such as the United Kingdom and France. The list of main recipients of FDI over the past decade is very mixed and contains highly developed countries such as the USA and Australia on the one hand, and emerging economies such as Mexico, Turkey, Korea and Poland on the other hand. The latter offer good investment opportunities due to major restructuring, implying high economic growth rates, an opening up of their domestic markets and large-scale privatisations. The reasons for the attractiveness of the USA for foreign direct investments can certainly not be ascribed to its persistent and large current account deficit. Strong economic growth in the past, the country's general openness towards foreign investors in most sectors, and the innovative ability of the economy are better able to explain the position of the

USA as the largest recipient of FDI worldwide in 2006. Figure 3.4 presents FDI inflows and outflows by OECD members only. Also here, the continuous recovery since the crisis in 2001 is visible. The increased importance of South-North and South-South investments can be seen only indirectly from the fact that the record levels from the year 2000 have not been reached, while globally FDI flows have risen back to 2000 levels.

While OECD countries still dominate the list of major donors and recipients of foreign direct capital, South-South investments as well as South-North investments are gaining importance. A number of takeovers by firms headquartered in emerging markets in OECD members have attracted considerable public attention recently. These South-North deals are often observed in the extraction industry and in raw materials (the takeover of the British-Dutch steelmaker Corus by Tata Steel from India, the takeover of Belgian Arcelor by Mittal Steel, the takeover of Canadian mining group Inco by Brazilian CVRD, or the takeover of Australian Rinker by Mexican CEMEX). In contrast, South-South investment more often takes the form of greenfield investments. China is one of the most important players in South-South investments. However, the figures are potentially blurred by so-called "round-tripping". For tax and other reasons, capital investments are flowing out of and back into China through Hong Kong, in order to exploit the sometimes more beneficial treatment that foreign investors enjoy in China. Estimates of the magnitude of these flows are as high as 25 percent of Chinese direct investments.

Figure 3.4: FDI inflows and outflows, OECD only



Source: OECD International Direct Investment Database.

Austria's External Economic Relations

4. Impact of international trade development on Austria

4.1 Impact of sectoral and regional trends in global trade on Austrian foreign trade

Julia Wörz (wiiw)

Sectoral and regional trends of global trade are positive for Austria and this will continue to be the case in the near future. Both the specialisation and dynamics of Austrian goods trade point to such a positive development.

At the sectoral level, the structure of global trade fits well with the structure of Austrian trade. Obviously, price increases in resources and raw minerals have led to a worsening of the terms of trade, but it is possible to adapt prices of exported goods to price hikes in imported raw materials, as nearly every competing country faces the same cost increases. Raw material prices reached their zenith in 2006; as a consequence, price developments over the next years should be less negative.

At the regional level, the expanding trade ties with the Balkan countries as well as with Romania and Bulgaria point to continuing market growth perspectives, as does the renewed economic vigour of Austria's biggest export market, Germany. On the other hand, the amplitude of the US downturn is still uncertain. Austria continues to have a relatively weak presence in fast-growing Asian countries, foremost China, but also in smaller dynamic Asian countries such as Singapore. A reason for this can be found in Austria's export specialisation.

4.2 Austria's foreign trade specialisation in comparison with the EU 15 and the EU 10

Jürgen Janger (WIFO)

Austrian export specialisation as measured by RCA values shows a clear trend towards increased specialisation in goods which require higher innovation and human capital intensities. This is also reflected in growing specialisation in industries where higher unit values lead to increased market shares, i.e., which are quality elastic instead of price elastic. The strongest specialisation is still achieved in traditional manufacturing.

4.3 Austria's external competitiveness as measured by market shares and unit values

Jürgen Janger (WIFO)

The process of structural change is less pronounced when looking at world export market shares and unit values. The biggest Austrian world export market shares at the sectoral level can be found in the production of wood, paper and metal goods. Food is the sector which is gaining most in market shares. This underlines not only the continuing specialisation in traditional manufacturing in Austria but also its continuing success. The relative market share of technology-oriented goods is growing but still relatively weak. The only sectors which are losing market shares are textiles, communications equipment and the manufacture of "other transport equipment". According to the relationship between market shares and unit value dynamics, Austrian manufacturing sectors are mostly engaged in successful quality competition. This is also a welcome development, as it means that higher market shares are obtained with increasingly quality-intensive products.

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

5.1 Economic development (including outlook for 2007-2008)

Stefan Ederer, Markus Marterbauer (WIFO)

After a period of restrained development, the Austrian economy regained speed in 2006. GDP grew in volume by 3.3 percent. The strong economic growth was produced by a substantial rise in exports (+7.5 percent in volume) due to the robust development in foreign markets. Imports, on the other hand, rose by only 5.6 percent, thereby improving the balance on current account. High corporate earnings, favourable sales expectations and high capacity utilisation caused firms operating in export markets to raise their investment activities. Investment in machinery and equipment rose by 2.1 percent. This was strongly supported by a 5.1 percent rise in construction investment. Private consumption, however, did not recover and grew in volume by only 2.1 percent. The main reasons for the small increase in consumption are a sluggish income growth and a rise in the savings rate. The strong economic growth led to an average annual increase in employment by 51,000 persons (+1.7 percent). For the first time since 2000, unemployment declined. However, because of a rise in foreign and domestic labour supply, the reduction of the unemployment rate was only slight. Consumer prices in 2006 rose by only 1.5 percent; the budget deficit was –1.4 percent of nominal GDP.

In 2007, the Austrian economy has been unchangeably benefiting from the strong momentum of exports and investment in Western and Eastern Europe and is expected to grow in volume by 3.4 percent, broadly the same rate as last year and 0.75 percentage points above average growth in the Euro area. Austrian exports are expected to increase by 9 percent in real terms, manufacturing output by 7.3 percent. Corporate earnings are still high, productive capacities fully utilised and business optimism undiminished, which translate into a sizeable increase in investment (+8 percent in machinery and equipment). The business cycle has thus passed the crucial stage from being entirely export-driven towards taking root in investment. Further support comes from construction activity, which is expected to grow by 5 percent as a result of a stable expansion in civil engineering, a steady recovery of residential building and a reinforcement of industrial construction activity. Nevertheless, the recovery is unlikely to turn into a cyclical boom for two reasons: first, the weakening international environment in the wake of slackening activity in the USA and the global financial crisis, and second, the persistent sluggishness of private consumption in Austria. The worldwide turbulences on financial markets originating from the sub-prime segment of the US real estate market and the slowdown of the US economy have hit the world economy while it is in a relatively robust condition. Growth in Asia, especially in China, is still very high. Nevertheless, it is still too early to evaluate the effects of the crisis on the global economy. The upward pressure on the Euro, a slump in real estate prices and a recession in the USA still represent considerable risks. In contrast to past cyclical episodes, this time it is unlikely that lively export and investment activity will give rise to a boom in private consumption. Private consumption is expected to edge up in volume by only 1.9 percent this year, thus remaining below its low-term average for the seventh year in a row. Private income growth is still sluggish. The strong economic growth will lead to a sizeable increase in the number of people employed, by 60,000 on an annual average. Against this background, the decline in unemployment by 15,000 is disappointingly small. Particularly the long-term unemployed have scarcely benefited from the cyclical boom, and for young job-seekers the situation has improved little so far. In spite of the high economic growth rates, prices have risen only modestly. In 2007, an increase of consumer prices by 1.9 percent is expected.

The lack of a rebound in consumer demand and the repercussions of the crisis on international financial markets will dampen the cyclical upswing earlier than expected. GDP growth in Austria in 2008 is projected to decelerate markedly (+2.4 percent in volume), but will nevertheless remain above the euro area average. A further reduction in unemployment is unlikely to occur. Because of the global economic slowdown, exports are expected to grow by 6.5 percent, markedly less than the year before. The investment boom has also passed its peak; investment in machinery and equipment will grow by only 4.5 percent. Private consumption is expected to rise by 2.1 percent, a modest increase with respect to 2007. Employment growth will also slow down to +30,000 persons, while the unemployment rate is expected to persist at the same level as in the previous year.

5.2 Price competitiveness

Stefan Ederer, Markus Marterbauer (WIFO)

International price competitiveness is determined by the development of relative prices and costs of domestic industries as compared with competitors in foreign markets. The indicators for price competitiveness showed an improvement for 2006. Unit labour costs relative to trade partners went down by 1.9 percent. With respect to Germany, a slightly improvement (–0.2 percent) has resulted. This enhancement of international competitiveness is mainly due to a strong increase in the productivity of the manufacturing sector. In 2007, this trend is still continuing. Relative unit labour costs will decrease by 1.7 percent; relative to Germany, they will remain constant. For 2008, WIFO expects this trend to continue. Unit labour costs relative to trade partners will decrease by 1.7 percent, relative to Germany by 0.9 percent. After an interim deterioration of international competitiveness between 2003 and 2005, this trend was reversed and since then, intensification has continued.

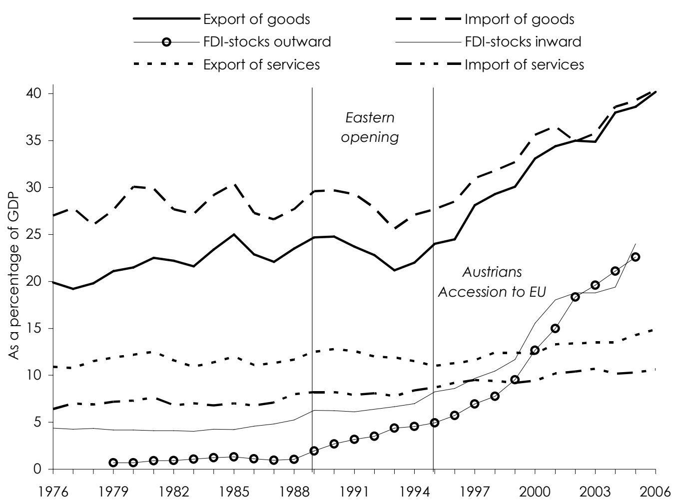
5.3 Overview of Austria's external economic relations – trade in goods, services and foreign direct investment

Susanne Sieber (WIFO)

Over the past decade, external economic relations have greatly increased in importance for the Austrian economy. Since Austria's accession to the EU, the export of goods quota has nearly doubled (now 40.2 percent); taking exports of goods and services together, this export quota amounts to more than 50 percent of gross domestic product.

In line with exports and imports of goods and services, the increasing globalisation of the Austrian economy is also reflected in the dynamic development of foreign direct investments. Both the trade (in goods) balance and the foreign direct investment balance showed a clear trend to improvement within the last years; both were nearly balanced in 2006. Real net exports of goods and services, as a part of total demand, still provided an important contribution to economic growth in 2006.

Figure 5.1: Development of Austrian export, import and foreign direct investment quotas



Source: Statistics Austria, OeNB data, WIFO calculations.

5.4 Austria's external performance position in international country rankings

Jürgen Janger (WIFO)

Many country competitiveness rankings feature subindices of external competitiveness, which are illustrated for Austria.

5.4.1 Austria's position in rankings of external competitiveness

On a normalised scale with 100 countries, Austria achieves top ten rankings in the KOF "Economic Globalization" Index and in the IFC Doing Business "Trading across Borders", and top twenty rankings in the AT Kearney/Foreign Policy Globalization Index, the Fraser Institute Economic Freedom of the World "Freedom to Trade Internationally" Index, the WIFO's external competitiveness version of the Global Competitiveness Index by the World Economic Forum and in the two UNCTAD FDI indices "Inward Potential" and "Outward Performance". Austria is placed far behind in the UNCTAD indices "Inward Performance" and "Transnationality" as well as in the IMD World Competitiveness Yearbook "International Trade" Index. The poor performance in the UNCTAD indices is due to Austria's below-potential inward FDI performance, while the reasons for the position in the IMD index are not clear from its construction.

5.4.2 Critical review of the rankings

The rankings usually provide information about three aspects of external competitiveness: performance, regulation and openness. Austria is usually well placed in rankings which emphasize exporting, while it does not fare as well in rankings which focus on FDI. As a small, open economy, Austria is much more open than bigger countries such as France or Italy. Relative to other small European economies, such as Denmark, Belgium or the Netherlands, Austria features the same or even higher levels of trade openness, but lower levels of inward and outward FDI stocks relative to GDP.

Rankings have been criticised for lacking methodological rigour, robustness and a correlation with real economic developments. For the purpose of country monitoring, only indices of openness and of law-based regulation are appropriate. E.g., the IFC Doing Business index provides a methodically relatively sound analysis of administrative burden on exporting and importing. It is based on the comparison of laws and regulations in daily practice. The performance components of the current indices are inappropriate, as they do not use relevant key figures such as export market shares, unit values or RCA values.

6. Austrian trade in goods

Susanne Sieber (WIFO)

6.1 Development in 2006 and outlook for 2007

In 2006, Austrian exports benefited from the highly dynamic world economy as well as from the good world trade performance. Particularly important for Austria was the economic recovery in Germany – exports to Germany provided the highest contribution to export growth – and in Italy. Thanks to the favourable international situation, Austrian exports expanded at a 9.5 percent growth rate (6.8 percent in real terms). For the first time, both nominal export and import values exceeded the € 100 billion mark. Imports developed less dynamically than exports (+8 percent in nominal figures, +3.8 percent in real terms), but more dynamically than in 2005. The trade balance was nearly balanced in 2006 (only minus € 0.5 billion). The increase in import prices was greater than in export prices, leading again to a deterioration of the terms of trade.

However, the official trade in goods figures for 2005 and 2006 were influenced by two different statistical effects. First, from 2005 onwards repair trade was no longer included in the trade statistics, leading to a level effect in 2005, and second, a correction of 2006 electricity trade figures was implemented, which again yielded a one-off level effect[1]. Both effects give rise to an underestimation of the actual trade development. After correcting the nominal figures for this statistical effect, two-digit growth rates result for goods exports in 2006 (approximately 12.3 percent and 9.2 percent for 2005). Similarly, the official figures underestimate the import performance (without the statistical effect, nominal import grew by approximately +10.4 percent in 2006 and +9.8 percent in 2005).

The ongoing price boom of oil in particular – although less dramatic than in 2005 – resulted again, despite slightly decreasing volumes, in a sharp increase in the value of oil imports (+20.4 percent). Altogether, all fuel and energy imports (excluding imports of electricity, which

[1] For more details, see *Seiringer* (2006), p. 735 and *Seiringer – Höllersberger* (2007) pp. 803-804.

were distorted by the statistical effect) were responsible for almost one quarter of the total import growth 2006.

After a slight deterioration of its position in 2005, Austria again gained nominal export market shares in 2006, probably due to the improvement of Austria's relative price competitiveness (see also Chapter 5.2). On the regional level the picture is more diverse. Whereas in the CEEC 5, market shares show a long-term downhill tendency, Austria has been able, for instance, to improve its market shares in Romania and the CIS. Nevertheless, despite the decreasing tendency, Austria still has a leading position in the CEEC 5 with regard to relative market shares, as Austria was able to take advantage of its know-how in economic relations between Eastern and Western Europe after the Eastern opening and establish a good position in trade relations with its Eastern neighbouring countries. However, since 1997 other Western countries have followed.

Table 6.1: Overview of Austrian trade in goods

	2004	2005	2006	2007[1]	2007[2] First half year
Exports			Billion €		
Values	89.9	94.7	103.7	114.8	55.8
			Percentage changes compared to the previous year		
Values	+ 13.9	+ 5.4	+ 9.5	+ 10.6	+ 10.8
Real	+ 12.5	+ 3.2	+ 6.8	+ 9.0	.
Prices	+ 1.2	+ 2.1	+ 2.6	+ 1.5	.
Imports			Billion €		
Values	91.1	96.5	104.2	114.1	55.0
			Percentage changes compared to the previous year		
Values	+ 12.5	+ 5.9	+ 8.0	+ 9.5	+ 8.3
Real	+ 11.7	+ 2.8	+ 3.8	+ 8.4	.
Prices	+ 0.7	+ 3.0	+ 4.0	+ 1.0	.
Balance			Billion €		
Values	– 1.3	– 1.8	– 0.5	0.7	0.9
Change	+ 0.8	– 0.5	+ 1.3	+ 1.2	+ 1.2
			Percentage changes compared to the previous year		
Terms of Trade	+ 0.5	– 0.9	– 1.4	+ 0.5	.

Source: Statistics Austria; WIFO calculations; WIFO prices. – [1] WIFO Forecast September 2007. – [2] Update 28 September 2007.

In the first half of 2007, the international framework was still favourable. The economic situation in Europe developed positively, with demand from Germany, Austria's most important trading partner, remaining strong. Benefiting additionally from the ongoing vitality of the world economy, nominal exports increased in the first half of 2007 by 10.8 percent (imports by 8.3 percent). According to the forecast for 2007, exports will rise by 10.6 percent (for nominal figures, +9 percent in real terms), imports by 9.5 percent (for nominal figures, +8.4 percent in real terms). The forecast for 2008 is slightly less optimistic. Through 2008, Austrian nominal exports should rise by 7.5 percent (in real terms by +6.5 percent).

6.2 Regional structure 2006

Although there is still a high export concentration on the EU-15 market (56.8 percent of total exports of goods), these shares have decreased over the last years. In contrast, the share of exports in the CEEC 21 have increased considerably, reflecting not only the strong economic ties Austria has built up to its neighbouring new EU member states since their opening in 1989, but also Austria's tendency to intensify its economic relationship with more distant south-eastern countries. In 2006, the CEEC 21 were already responsible for 20.1 percent of Austria's exports. Exports to Romania and Bulgaria expanded to an extraordinary degree in 2006 (+25 percent), a year before their accession to the EU. Also worth mentioning are the clearly more positive growth rates of exports to neighbouring Eastern European countries, which rose considerably compared to previous years (Czech Republic +15.7 percent, Hungary +8.8 percent, Slovenia +9.5 percent). Altogether, almost three quarters of Austrian foreign trade consists of an exchange of goods within the EU. Parts of the extra-EU trade also developed very dynamically in 2006. High growth rates as compared to the previous year could be seen in exports to Russia (+32.5 percent) and Ukraine (+39.3 percent) as well as to Saudi-Arabia (+47.3 percent) or the United Arab Emirates (48.5 percent). The USA is still the third most important market for Austrian goods, behind Germany and Italy. Exports to the USA showed clearly above-average development in 2006, although the figures were affected by the exports of the Klimt paintings in March 2006, a one-off transaction amounting to approximately € 250 million.

6.3 Sectoral structure in 2006

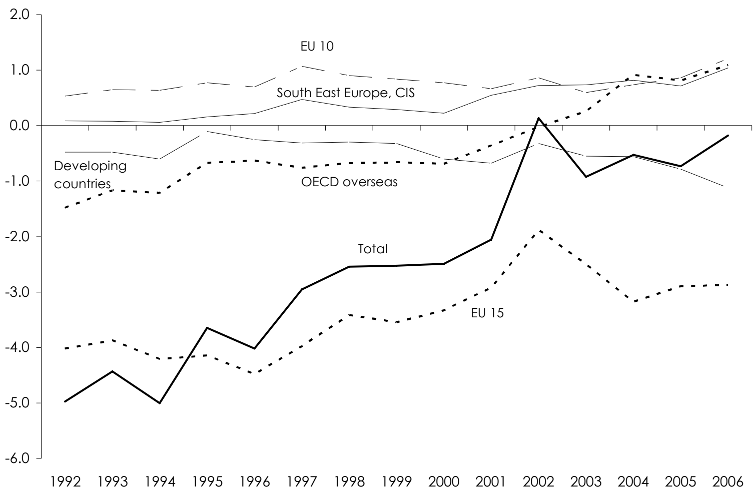
In the long term, Austria's trade shows a tendency towards the export of more sophisticated products. For instance, the share of exports of machinery and vehicles – this category encompasses a great number of sophisticated products – has been continuously increasing for years. Also worth positive mention is the increasing share of chemical exports; especially pharmaceutical products can be classified as technology-oriented products demanding high qualifications. Both main groups showed dynamic development in 2006 (machinery and vehicles: +10.7 percent; chemicals: +17.9 percent). An important contribution to export growth came from the automobile industry. Exports of passenger cars rose more than eightfold as compared to the figures of 1994.

6.4 Trade balance development as of 2006, including regional and sectoral structure

As already mentioned, the trade balance was nearly in equilibrium (minus € 0.5 billion) in 2006. The Austrian balance of trade has shown a clear trend towards improvement over the last years. A clearly positive contribution to this improvement came from the South Eastern Countries, the CIS, OECD overseas countries and the new EU member states.

With the exception of energy and fuel, nearly all main commodity groups showed an improvement in trade balance.

Figure 6.1: Austrian trade balance as a percentage of GDP



Source: Statistics Austria and WIFO data; WIFO calculations.

6.5 Austria's position in trade according to industry taxonomies

Looking at Austrian export specialisation according to three different industry taxonomies reveals approximately equal shares of exports of traditional products and exports of more technology-oriented products. Nearly half of all exports can be allocated to products in which quality competition dominates. However, in terms of an industry classification based on qualification requirements, the largest share of Austrian exports constitutes medium-skill products. Although Austrian exports have shown a desirable structural change towards increasing export shares of more sophisticated products (such as technology-oriented, high-skill products, which are ideally dominated by quality competition), this change has been slow and less dynamic than in the EU as a whole. For Austria, as one of the countries with the highest per capita GDP, promotion of this structural change toward more sophisticated exports is, however, essential.

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7. Austrian trade in services

Susanne Sieber (WIFO)

7.1 General introduction to trade in services

The volumes of trade in services may differ depending on the chosen definition. For instance, the definition used within GATS negotiations is a rather broad one, as it includes the following four modes of supply: cross-border trade, consumption abroad, commercial presence, and presence of natural persons. The following sections of this chapter are based on data from the balance of payments, which represents a much narrower definition of trade in services than the aforementioned GATS definition.

7.2 Brief Information about the new balance of payments survey

In 2006, the Austrian central bank introduced a new survey basis for the compilation of the balance of payment. The old indirect inquiry system – in which notification of transactions came predominantly from Austrian banks – was replaced by direct questioning of exporting or importing firms. The results of this new survey will allow a higher degree of disaggregation than in previous years. First aggregated results of the balance of payment based on the new survey were already published in the spring of 2006; more detailed disaggregated data will be published probably by the end of the year.

7.3 Development of trade in services, 2004 to 2006

Within the last three years, service exports developed more dynamically than service imports, resulting in an ongoing improvement of the saldo.

Figure 7.1: Development of trade in service exports and imports
2004 to 2006

Source: OeNB, update May 2007.

7.4 Structure of trade in services in 2006

The most important sectors within Austrian service exports are travel, which accounts for approximately one third of all service exports, followed by business services and transportation, each of which accounts for about one quarter. Other sectors, such as construction, financial services or computer services, only achieve shares of less than 5 percent of total service exports. The trade balance is positive within most service sectors; one clear exception is the category of patents and licences.

7.5 Most important trading partners

Germany is by far Austria's most important trading partner, accounting for more than one third of all service exports and more than one quarter of all service imports. In contrast to the trade in goods balance, which is in deficit, trade in services results in a surplus of approximately € 7 billion. Additional top partner countries for Austrian service exports are Switzerland, Italy and Great Britain; the trade balance with these countries is, again, positive.

7.6 Main partner regions and countries for selected service sectors

The following two examples differ strongly from the overall regional pattern of total service exports or imports: First, within the financial or banking sector, Austrian firms export overproportionally to Central and Eastern European countries. Second, with respect to patents and licences, the main source of origin for imports are the EU 15; just under one sixth of total imports comes from countries other than the old member states (extra-EU 15).

7.7 Tourism

Egon Smeral (WIFO)

Within Europe, the Austrian tourism sector is losing further market shares. The main reasons for these market share losses are the facts that Austrian tourism is concentrated mainly in stagnating markets (such as Germany, Italy, Switzerland or the Netherlands), that the emergence of new destinations is reducing the demand for Austrian tourism services, and that this decrease in demand cannot be replaced quickly enough by guests from new and growing markets. Parallel to the aforementioned reasons, the development of a new range of service products is taking too much time. Unless these problems are dealt with, additional losses of market shares, even in the medium term, seem probable. In order to avoid such a situation, it will be necessary to implement a growth strategy that focuses on increasing internationalisation and on extending year-round tourism. These activities could be co-ordinated by the federal government.

8. Austrian foreign direct investment

Susanne Sieber (WIFO)

8.1 Austria's position in international comparison

Austrian foreign direct investment (FDI) flows developed positively within the last year, in line with the international trend. The small decrease in 2006 as compared to 2005 seems to have been just a transitional decline, as FDI flows have reached new record levels in the first half of 2007 (outward flows of € 14 billion, inward flows of € 12 billion).

Also, the stock values of Austrian foreign direct investments increased continuously within the last years. For 2005, a stock of outward FDI amounting to € 55.5 billion was recorded, while the stock of inward FDI amounted to € 58.9 billion. Austria's outward investment quota – measured as foreign direct investment stock in percent of GDP – showed a strong improvement from 2.9 percent in 1990 to 24 percent in 2006, signalling solid progress in Austria's internationalisation process. Nevertheless, even though Austria is catching up in this respect, the quota is still far below the EU-25 level (44.9 percent).

8.2 Development and structure of Austrian outward and inward foreign direct investment by regions

In contrast to the regional structure of exports in goods or of Austrian inward foreign investment, the weight of Austrian investments in the EU 15 – approximately one third of total investments – is far less prominent. In 1990 more than 50 percent were still invested in the EU 15. Similarly, the share of Austrian investments in Germany decreased from 24 percent in 1990 to 12.7 percent in 2005. At the same time, the share of investments in Central and Eastern European countries increased sharply, reaching a new record share level of 43.6 percent of all Austrian outward FDI stocks in 2005. Austria was able to stake an excellent claim in the CEECs due to its pioneering role. However, now that other countries are entering these markets, some market share losses are unavoidable. Nevertheless, Austria still holds an extremely strong position within the Central and Eastern European countries.

As regards Austrian inward foreign direct investment, Germany is still the most important investor. Between 1993 and 2005, the share of the EU 15 in total investment stock increased, while the share of Swiss investments decreased.

Table 8.1: Development of foreign direct investment, worldwide and in Austria

	Outward foreign direct investment flows			Outward foreign direct investment stocks		
	World	Austria	Austria	World	Austria	Austria
	Billion €		Percentage share	Billion €		Percentage share
1999	1,039	2.85	0.27	5,181	19.04	0.37
2000	1,341	5.98	0.45	6,673	26.67	0.40
2001	832	3.38	0.41	7,537	32.35	0.43
2002	572	6.14	1.07	7,089	40.51	0.57
2003	495	6.08	1.23	6,951	44.31	0.64
2004	706	6.47	0.92	7,453	49.77	0.67
2005	673	9.01	1.34	8,967	55.48	0.62
2006	968	7.94	0.82	9,472	.	.
	Inward foreign direct investment flows			Inward foreign direct investment stocks		
	World	Austria	Austria	World	Austria	Austria
	Billion €		Percentage share	Billion €		Percentage share
1999	1,030	2.59	0.25	4,917	23.36	0.48
2000	1,527	9.23	0.60	6,244	32.70	0.52
2001	930	6.36	0.68	7,047	38.95	0.55
2002	658	0.15	0.02	6,474	41.49	0.64
2003	499	5.49	1.10	6,481	42.63	0.66
2004	597	2.56	0.43	7,026	45.77	0.65
2005	760	8.67	1.14	8,517	58.87	0.69
2006	1,040	4.54	0.44	9,111	.	.

Source: Values for the world: UNCTAD, World Investment Report 2007; values for Austria: OeNB (update 16 October 2007); WIFO calculations.

8.3 Sectoral structure of Austrian outward and inward foreign direct investment

Investments in the service sector clearly prevail over investments in the manufacturing sector; this holds true for both directions, inward and outward FDIs. In 2006, the share of investments in the service sectors attributable to total outward FDI stocks reached 76.1 percent, the same share attributable to inward FDI stocks came to 78.3 percent. Within the Austrian outward FDI stock in service sectors, the highest shares were reached by the financial and insurance services, the business services and merchanting and other trade-related services.

Within the manufacturing sectors, the highest shares both in Austrian outward and inward FDI stocks in service were achieved by the chemical industry.

8.4 Development of employment of Austrian foreign direct investment

In 2005, the number of persons employed in Austrian affiliates abroad totalled 431,744. This means that employment figures have more than tripled in comparison to 1996 and are nearly ten times as high as in 1990. In 2001, for the first time, the number of employees in Austrian affiliates abroad was higher than the number of employees of foreign direct investment enterprises in Austria.

8.5 Profitability of Austrian foreign direct investment

The yield of Austrian outward direct investments in the CEECs has continuously improved over the past years, contributing substantially to the improvement of total Austrian outward investments, which reached a new record in profitability in 2005 (+10.8 percent). The high – and increasing – profitability of investments in the CEECs demonstrates how successful Austria has been in grasping the opportunities of the Eastern opening. Nevertheless, the level of profitability of inward FDI stocks is even higher (2006: 13.8 percent). One reason for the lower profitability level of Austrian outward direct investments compared to that of inward direct investments might be the young age of investments in the CEECs, as generally a positive relationship exists between the age and the profitability of foreign direct investments.

Surveys of Trade-related Topics

9. Current status of the Doha Development Agenda (DDA) negotiations

Olga Pindyuk (wiiw)

The Doha Round of WTO multilateral negotiations, launched in Doha (Quatar) in November 2001, has experienced a number of stalemate periods, when negotiations had to be suspended as the parties involved seemed unable to find compromises on a number of issues, in particular on the degree of domestic support decline in agriculture and the coefficients to be applied in the Swiss formula, to be used for cuts in NAMA (non-agricultural market access) tariffs. According to *Evenett* (2007), as the attempt to conclude the Doha Round by mid-2007 failed, the next most probable completion date, due to the US presidential election cycle, is 2010 or 2011.

The factors underlying the sluggish progress of current multilateral negotiations are: perceived low costs of suspension (as many countries are beneficiaries of preferential trade agreements and the growth of regional and bilateral agreements has intensified recently), the focus on non-economic (development) goals (which may have made many exporters reluctant to participate in the negotiations), the replacement of the traditional bipolar (USA versus EU) structure by a multipolar one (with greater importance of developing countries, especially Brazil, China and India; *Sally,* 2006, *Evenett,* 2007, *Baldwin,* 2007), and flaws in the organisation and procedures of the negotiations (*Evenett,* 2007).

There seems to be a broad consensus among economists that a completion of the round is to be desired in order to avoid further proliferation of preferential trade agreements, which increase the costs of trade, promote discrimination and fail to stimulate national trade reforms. Advocates for a narrow agenda argue that any result, however modest – ranging from a consolidation of prior trade reforms to any moderate package involving only parts of the full agenda – is to be preferred in order to achieve a formal completion of the round (*Evenett,* 2007, *Francois,* 2007, *Sally,* 2006). Other economists are in favour of a broad-based approach to liberalisation, which spans many areas and thus helps to create new opportunities to compensate for losses (*Hoekman,* 2007). Many simulation studies show that the narrow agenda of the Doha Round (both in terms of a limited degree of liberalisation and a limited scope of sectors covered) would bring very small gains to the WTO members, especially to developing countries, which could even suffer from net income losses (*Anderson – Martin,* 2007, *Häberli,* 2007, *Kinnman – Lodefalk,* 2007, *Hoekman – Mattoo,* 2006).

Questions thus arise about the shape of aid or the form of compensation developing countries should receive in case they are subject to losses as a result of multilateral liberalisation. Different approaches exist concerning the use of Special and Differential Treatment (SDT) and other forms of preferences granted to developing and least developed countries. While some advocate increased special treatment to developing countries (*Collier,* 2006, *Jensen – Gibbon,* 2007), others warn of the danger of an "SDT trap" (*Häberli,* 2007). *Hoekman* (2007) argues that existing SDT provisions actually have turned out to be inefficient, as they have not resulted in the desired export diversification. In his opinion, adjustment costs need to be considered more explicitly in the process of multilateral negotiations; compensation payments for giving up current preferences or aid for trade payments should be used to bolster trade capacity in poor countries and to facilitate adjustment.

To conclude, the major question is whether the WTO members will show enough political will and organisational capacity to reach agreement on the issues in the current round. The shape of special and differential treatment of developing countries is a key issue to be solved in order to reach progress in the negotiations. Formal liberalisation can be accepted as an outcome only when the threat of the round failure becomes very high.

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10. Europe's and Austria's Energy Dependence

Edward Christie (wiiw)

Western Europe's energy dependence has long been an important issue, especially with respect to its high import dependence with respect to crude oil and natural gas. The effects of this energy dependence are partly compensated by relatively low overall energy intensity of GDP (notably as compared to the United States). On the other hand, the region's import dependence is forecast to rise in the medium term, primarily due to the depletion of North Sea reserves. Some Western European countries are already quite vulnerable to possible supply shocks. In the case of petroleum products, these are, first and foremost, Finland, Belgium, Greece and Sweden. In the case of natural gas, the vulnerable countries are Finland, Austria, Italy and Germany. From the point of view of sustainability of energy supply, the most favourable position is that of France, thanks to its significant nuclear electricity generation capacity and its highly diversified pattern in terms of source countries for fossil fuel imports.

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