

# Austria's Economic Activities in CESEE

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## 1 Introduction

The development of the Austrian economy in the last two decades was determined by two major political events: the fall of the Iron Curtain in 1989 and Austria's accession to the European Union in 1995. Both events caused a major reorganization in the Austrian economy, which was aimed at improving the country's competitiveness in international markets especially during the opening of markets in the EU and the Central, Eastern and Southeastern European (CESEE)<sup>2</sup> countries. The following data<sup>3</sup> clearly highlight the success of this reorganization: While real Austrian GDP grew by 59% from 1989 to 2008, real goods exports (services) recorded a growth of 246% (106%). With export growth exceeding import growth, Austria's trade balance has been positive since 1998 (2008: 4.7% of nominal GDP). Nominal foreign direct investment (FDI) to the euro area went up by more than 1,600% between 1990 and 2007. Starting almost from zero, nominal FDI to CESEE countries even posted a growth rate of 12,500%. These developments have been frequently analyzed and discussed in the literature (e.g. Wolfmayr, 2004, for exports; Hunya, 2008, and Sieber, 2006, for FDI). The overall macroeconomic growth and employment effects in Austria are also widely discussed (e.g. Breuss and Schebeck, 1998, or Breuss, 2006).

This article provides a short review of the main economic effects the opening of the CESEE markets had on Austria up to 2008. It is structured as follows: Section 2 discusses the development of Austrian exports and section 3 that of Austrian FDI flows to CESEE countries. Section 4 describes the overall growth and employment effects in Austria that can be attributed to the closer economic links between Austria and the CESEE countries. Section 5 concludes.

## 2 Austria's Exports to CESEE Countries

The trade relations between Austria and the CESEE countries, which have a long historical tradition, have undergone a distinctive boost since 1989. However, the history of Austrian goods exports to CESEE can by no means be described as a linear process. To understand the huge increase of Austrian exports to CESEE over the last 20 years, we have to consider the influence of both economic and political factors as well as different historical developments. For the period between 1955 and 1989, the history of Austrian exports to Eastern Europe can roughly be divided into three phases (see Ragacs and Vondra, 2009). First, the ten years between the end of World War II and the ratification of the Austrian State Treaty were dominated by reconstruction activities. While, in 1937, 33.4% of Austrian exports had gone to the countries of the former Austro-Hungarian

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<sup>2</sup> There is no consistent definition for the region generally referred to as Eastern Europe. In this article the terms "Eastern Europe" and "CESEE countries" refer to countries which had been members or associates of the former Council for Mutual Economic Assistance (except Cuba, Vietnam and East Germany after reunification) and their successor states unless stated otherwise in the text.

<sup>3</sup> GDP and export data were provided by Statistics Austria. For figures on FDI (excluding special purpose entities and investment in private real estate) stocks, see www.oenb.at (Statistics and Reporting). Data on stocks are available for the period from 1990 to 2007. Except for employment, flow data are available up to the second quarter of 2009 but are not directly comparable with stock data. For a detailed analysis of both data types, see OeNB (2009).

Empire, this rate declined to 19.6% in 1947 and to 11.3% in 1955 (Stankovsky, 1998, p. 675). Second, in the 20 years following the signing of the State Treaty, Austrian exports to Eastern Europe strengthened again. During this time, trade relations were influenced by the demand monopoly of Eastern European governments and, therefore, also by the political and economic environment (Stankovsky, 1967). Third, from 1975 to 1989, the Austrian export share to CESEE clearly diminished. This decline was attributable to the Eastern European strategy of debt-financing the access to high-technology products, which turned out to be unsustainable (Fidrmuc et al., 2008, p. 469).

The last 20 years of trade relationships between Austria and CESEE were characterized by a massive expansion, with Austrian exporters quickly turning historical ties and geographic position into competitive advantages.

In the following, we will focus on the period from 1989 to the present. The rapid increase in the trade share of nominal goods exports to the CESEE countries in this period is shown in the left-hand panel of chart 1.

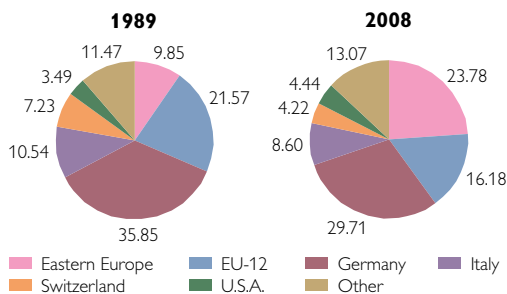
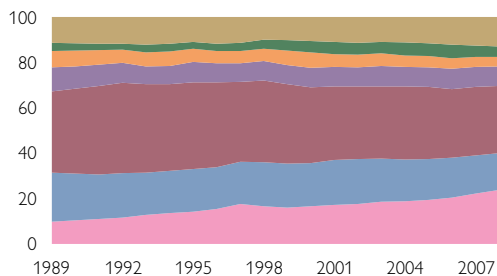
While in 1989, the share of Austrian exports to the CESEE countries amounted to only 9.8%, it went up to 23.8% by 2008. This rise took place at the comparative expense of exports to the old EU countries and Switzerland. In the right-hand panel of chart 1, the export shares of different regions are plotted by goods classes,

Chart 1

## History and Structure of Austrian Exports

### Goods Exports to Target Countries or Regions

% of nominal overall goods exports

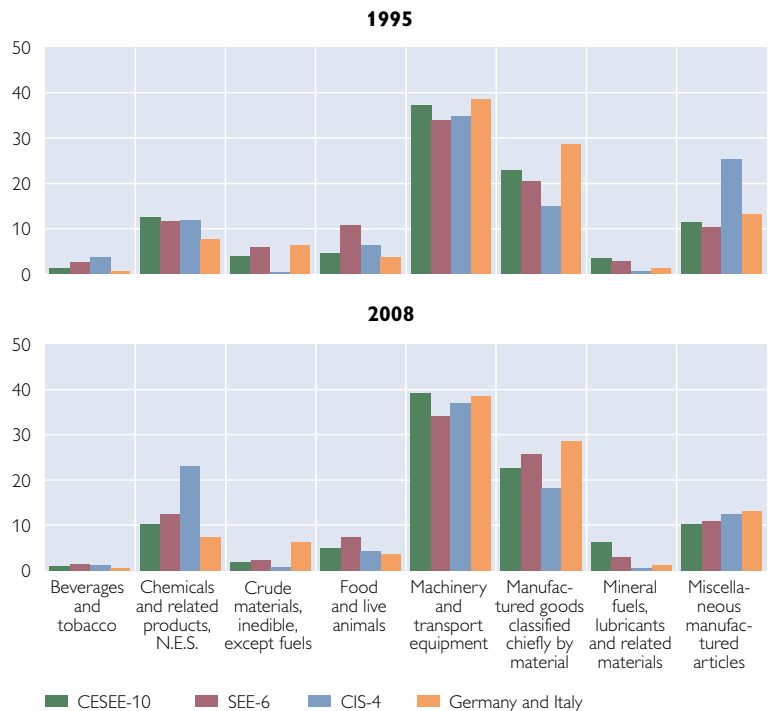


Source: Statistics Austria, OeNB, authors' calculations.

Note: EU-12: BE, DK, FI, FR, GR, IE, LU, NL, PT, ES, SE, UK. CESEE-10: BG, CZ, EE, HU, LV, LT, PL, RO, SK, SI. SEE-6: AL, BA, HR, MK, ME, RS. CIS-4: BY, MD, RU, UA. Eastern Europe: CESEE-10, SEE-6 without MK, CIS-4.

### Comparison of Export Shares of Selected Goods Relative to Total Exports to the Respective Region

%



comparing 1995<sup>4</sup> and 2008. The Austrian export industry is dominated by companies that produce and trade machinery and transport equipment. These exports account for almost 40% of Austria's total exports – a constant figure over the time horizon. Overall, the comparison of 1995 and 2008 reveals that the export structure did not change noticeably over time. However, there is a tendency toward exporting a bigger share of finished products (e.g. chemicals and related products) compared to basic materials (e.g. crude materials). Over the last two decades, the share of exports to CESEE in total Austrian exports more than doubled. Today the CESEE region – in its broadest definition – comprises 27 countries that differ with respect to size, stage of transition, current degree of development and many other factors. Therefore, it is useful to analyze the development of Austrian exports to this region for certain subsamples. Table 1 shows the shares and growth of exports to three distinct country samples: first, for Austria's four CEE neighbors, i.e. the Czech Republic, Hungary, Slovenia and Slovakia (CEE-4); second, for a broader set of CESEE countries; and third, for a sample including the CIS and Mongolia.

Table 1

### Export Shares and Export Growth (Goods, Nominal) of Selected Country Aggregates

	Exports in % of total exports				Export growth			
	1989–1993	1994–1998	1999–2003	2004–2008	1993–1998	1998–2003	2003–2008	1993–2008
	Period averages				%			
CEE-4	5.6	10.0	10.5	10.7	112.7	38.7	62.6	379.8
CESEE-10	2.2	3.8	5.0	7.1	172.7	85.3	108.9	955.7
CIS+MN	0.7	1.8	1.7	3.2	47.8	110.4	168.2	734.4
CESEE-27	8.4	15.6	17.2	21.0	113.2	56.4	90.6	535.8
<b>Total exports</b>	–	–	–	–	<b>65.8</b>	<b>40.1</b>	<b>48.7</b>	<b>245.6</b>

Source: Statistics Austria.

Note: CEE-4: CZ, HU, SK, SI<sup>1</sup>.

CESEE-10: AL, BA<sup>1</sup>, BG, HR<sup>1</sup>, EE<sup>1</sup>, LV<sup>1</sup>, LT<sup>1</sup>, PL, RO, RS (before 2006: YU).

CESEE-27: CEE-4, CESEE-10, CIS+MN;

CIS: Commonwealth of Independent States<sup>1</sup>.

<sup>1</sup> For these countries and aggregates, data are only available from 1992 onward.

The CEE-4 countries have always been the most important export markets for Austria, with around half of total exports to the whole region going to these countries. At the same time, Austria stepped up exports to countries beyond the CEE-4 at an above-average rate. This can be seen in both export shares and export growth. Moreover, export growth figures reveal that Austrian exporters focused on countries close to Austria at first and began to pay more attention to the other countries in the region only during the last few years.

### 3 Austria's Foreign Direct Investment in CESEE

Austria's strong ties with the CESEE countries are even more evident from FDI data. The considerable increase in Austrian FDI into these countries helped improve the historically very low overall Austrian FDI activity. In 1990, Austria's overall outward FDI stocks amounted to only 2.8% of GDP (inward FDI: 6.4%).

<sup>4</sup> For many CESEE countries, these data have only been available since 1995.

Over the last two decades, both ratios went up considerably and in 2007 outward FDI reached a 37.9% share in GDP (inward FDI: 39.9%); hence, both ratios now exceed the world averages in FDI (OeNB, 2009, p. 8).

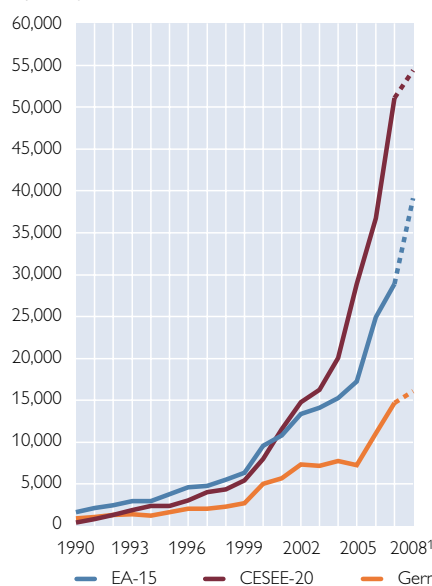
The left panel in chart 2 shows the enormous increase of nominal Austrian FDI between 1990 and 2007. Extrapolations of the 2007 FDI stock data for 2008 (based on 2008 FDI flow figures) indicate increasing overall FDI expenditures even for 2008 (see the dotted lines in the left and central panels of chart 2). Since 1993, Austrian FDI to the CESEE countries has outperformed Austrian FDI flows to Germany and, since 2001, Austrian FDI to the euro area as a whole. When we look at the change in the relative importance of target regions for Austrian FDI since 1990 (central panel in chart 2), the significance of the CESEE countries is even more striking. Starting at 10% of total FDI in 1990, the share of Austrian FDI to CESEE went up to nearly 50% in 2007. Over the same time horizon, the relative importance of Austria's FDI to the euro area decreased from about 45% in 1990 to less than 30% in 2007. The third panel in chart 2 shows the staff numbers of Austrian direct investment enterprises abroad, broken down by target regions. Starting from figures close to zero, Austrian direct investment enterprises predominantly generated employment in the CESEE countries. In 2007, a total of 573,300 persons were employed by Austrian direct investment enterprises, of which close to 407,900 (71%) in the CESEE countries (OeNB, 2009, p. 14). However, Austrian FDI also creates jobs in Austria. "A comparison of Austrian direct investors' employ-

Chart 2

### Development of Austrian FDI and of FDI-Induced Employment in CESEE

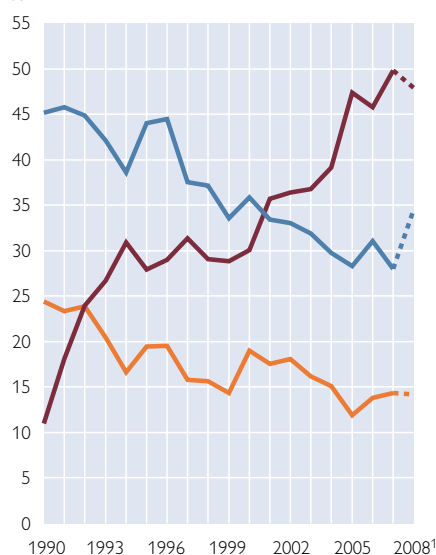
#### Austrian FDI to CESEE, the Euro Area and Germany

EUR million



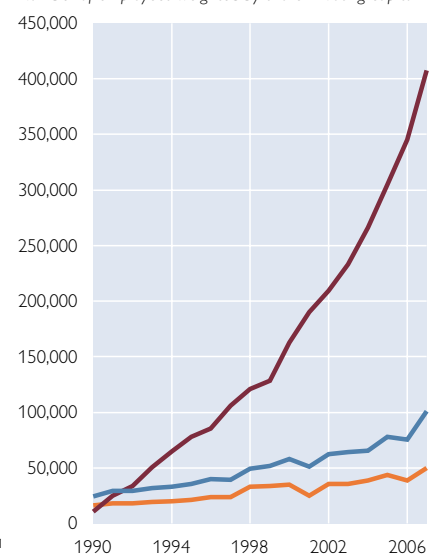
#### Austrian FDI to CESEE, the Euro Area and Germany in % of Total Austrian FDI

%



#### Employment in Austrian FDI Target Countries

Number of employees weighted by share in voting capital



Source: OeNB.

<sup>1</sup> 2008: Extrapolation based on FDI flow figures.

Note: EA-15: BE, DK, FI, FR, DE, GR, IE, LU, NL, PT, ES, SE, UK, SK, SI (since 2007).

CESEE-20: AL, BY, BA, BG, HR, CZ, EE, HU, LV, LT, MK, MD, ME, PL, RO, RU, RS, SK, SI, UA.

Double counting for Slovenian FDI since 2007. Both FDI stock data and employment data are available from 1990 to 2007.

ment figures at home and abroad shows that, for every 100 persons employed by the direct investor, another 152 are on the payroll of direct investment enterprises abroad” (OeNB, 2008, p. 17).

The reasons for the conspicuous increase of Austrian FDI are similar to those for the development of exports to the CESEE countries: Historical ties and Austria's geographic position have been transformed into competitive advantages. This also becomes evident from the fact that most of Austrian FDI has been invested in the CEE-4 and that Austria serves as the basis for many firms active in CESEE. Table 2 shows several FDI-specific indicators for CESEE as a whole, for selected countries and, for reasons of comparison, also for Germany.

Table 2

### Austrian FDI Stocks, Growth, Shares and FDI-Induced Employment in CESEE and Selected Countries

	FDI stocks (EUR million)		FDI growth		FDI in % of total Austrian FDI		Employment in target countries	
	1990–1998	1999–2007	1990–1998	1999–2007	1990–1998	1999–2007	1990–1998	1999–2007
	Period averages		%		Period averages		Period averages	
CESEE-20 <sup>1</sup>	2,290	21,432	970	832	25	39	63,902	249,705
Germany	1,564	7,638	159	438	20	16	21,483	37,126
Poland	139	2,546	3,050	518	1	5	3,464	21,856
Slovakia	170	2,044	45,400	658	2	4	3,616	26,012
Slovenia	190	1,115	790	276	2	2	2,371	7,502
Czech Republic	541	4,047	11,020	489	5	8	15,387	56,443
Hungary	1,095	3,797	396	344	13	8	35,453	54,941
Russia	35	1,256	-156	3,975	0	2	740	11,879

Source: OeNB.

<sup>1</sup> See definition in chart 2.

Note: Both FDI stock data and employment data are available from 1990 to 2007.

Employment: Number of employees in foreign firms weighted by share in voting capital.

The sharpest increase of Austria's total FDI to CESEE countries occurred in the period between 1990 and 1998, but even between 1999 and 2007, the increase remained very strong. In the period from 1999 to 2007, about 27% of Austria's total FDI was invested in the CEE-4 and in Poland. Russia has become comparatively more important for Austrian investors since 1999. In the Czech Republic and in Hungary, Austrian FDI generated even more employment than in Germany.

#### 4 Growth and Employment Effects of East-West Integration in Austria

The fall of the Iron Curtain had two major effects on Austrian external trade: On the one hand, Austrian firms were abruptly confronted with a larger market, which led to an increase in firms' profitability. On the other hand, Austrian firms found themselves in stronger competition, especially with low-cost countries, which forced them to improve efficiency. The overall effects of East-West integration on macroeconomic growth and employment in Austria have been analyzed in a multitude of studies. Table 3 presents a selection of estimated effects on GDP growth and employment.

The aggregate growth and employment effects are found to be positive in all studies on the topic, but the results vary markedly according to the simulated time

Table 3

**Growth and Employment Effects of East-West Integration in Austria**

Study	Analyzed effects	Time horizon	Effects on the Austrian economy					
			Average annual effect			Cumulative effect		
			GDP		Employment	GDP		Employment
			Percentage points		Thousands	Percentage points		Thousands
Breuss, Schebeck (1998a)	Opening-up of Eastern Europe	1989–1997	0.5	0.3	9.6	3.6	2.6	76.9
Breuss, Schebeck (1998b)	EU eastward enlargement	2002–2010	0.14	0.1	3.0	1.3	0.8	27.5
Breuss (2002)	Costs of delayed eastward enlargement	Six years	–0.13	n.a.	–1.3	–0.8	n.a.	–8.0
Breuss (2006)	Opening-up of Eastern Europe	1989–2003	0.5	n.a.	10.0	3.5	n.a.	77.0
Breuss (2006)	EU eastward enlargement	2004–2014	0.15	n.a.	n.a.	1–1.25	n.a.	3–28

period. As expected, the positive effects are stronger for time periods closer to the fall of the Iron Curtain. However, when analyzing the effects on specific sectors, the empirical results are rather heterogeneous. Using input-output tables, Falk and Wolfmayr (2006) showed in an analysis for seven EU countries (including Austria) that imports from low-wage countries also have significant negative employment effects in specific sectors, especially in manufacturing. In contrast, by estimating relative factor demands, Pfaffermayr (2001) found for a smaller country sample for the period from 1990 to 1996 that job creation by Austrian manufacturing firms in CESEE is complementary to domestic job creation.

## 5 Summary

This article presents the effects on the Austrian economy of 20 years of East-West integration. The fall of the Iron Curtain had a remarkably positive effect on the development of Austrian exports and FDI. Furthermore, even Austria's average macroeconomic growth performance was positively influenced, as was average employment both in Austria and in the CESEE countries. However, this does not imply that all economic sectors have benefited equally and that there have not been any adverse effects at all. Moreover, overall export and FDI growth rates to CESEE have been decreasing over time, for two main reasons: First, growth rates used to be exaggerated at the beginning of the transition process given very low initial growth levels. Second, as other competitors moved into the market, Austrian companies' first-mover advantage, which had been attributable to historical links and geographical vicinity, diminished and Austrian firms are now facing strong international competition. Finally, like all developed countries, Austria has been hit hard by the ongoing international crisis: In the first two quarters of 2009, total real exports of goods declined by 21%, and the FDI flow figures show a collapse of Austrian FDI activity. However, Austrian firms will be able to maintain their relative market position in the long run if the productivity gains that were triggered by the initial phase of Austria's EU membership and the opening-up of the CESEE countries will continue in the future.

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