

25 years of EU membership for Austria –  
stability and growth through integration

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## Editorial

### 25 years of EU membership for Austria – stability and growth through integration

Twenty-five years ago, on January 1, 1995, Austria joined the European Union, alongside Finland and Sweden. The country's EU accession – which was driven by political, and even more so by economic arguments – was preceded by an extended period of convergence toward the EU. As a small open economy in the heart of Europe, Austria had aligned its trade policy with the EU as a member of the European Free Trade Association (EFTA) through EFTA's free trade agreement with the European Economic Community in 1973 and through participation in the European Economic Area in 1994. However, it was only after joining the EU in 1995, that Austria was granted unrestricted access to the European single market and, subsequently in 1999, membership in Economic and Monetary Union (EMU).

EU accession has had a major impact particularly on Austrian foreign trade, real GDP growth and hence also income and productivity developments. It has also had profound implications for the labor market, the financial market and the regulatory environment, acting as a catalyst for necessary changes in all the aforementioned areas. Numerous empirical studies confirm that Austria has benefited from substantial positive growth effects, which went hand in hand with strong employment growth.<sup>1</sup> The Austrian economy has profited most from common market participation and EU enlargement, as is shown in the article by Breuss in this issue. However, it would only be part of the story to assess the impact of EU and EMU membership against economic effects observed for Austria alone. After all, EU/EMU membership has had wide-ranging and, above all, long-term implications for Austria's institutional set-up and thus for economic, monetary and fiscal policy-making processes. Moreover, Austria's entry into the EU and EMU allowed the country to actively participate in driving change in Europe – both from an economic and a socio-political perspective. For instance, Austria contributed to all subsequent enlargement rounds and helped lay down the specific design of EMU, implement the Eurosystem's monetary policy as well as review and enhance the EU's regulatory framework.

While economic integration has followed a steady path in recent decades, political integration has proven to be a slow and challenging process, hampered by complex and diverging interests among EU Member States and fraught with struggles and setbacks, such as the withdrawal of the United Kingdom from the EU. Yet, in the face of new economic and socio-political challenges closely associated with globalization, Member States will have to join efforts and stand united more than ever before. This was of the essence to overcome the financial and economic crisis of 2008, and also applies to the recent emergence of the COVID-19 pandemic jeopardizing lives and livelihoods. Today, crises and conflicts set off at the local or regional level tend to translate into global upheaval more often and more quickly by historical standards, given close international trade and production linkages. With a view to tackling such challenges and cushioning their impact, EU/EMU action is more effective than action taken at national level, as is evidenced by the Eurosystem's single monetary policy. Following the complete liberalization of capital

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<sup>1</sup> Beer et al. (2017).

movements, Austria had to abandon its tested hard currency policy. Subsequently, the Oesterreichische Nationalbank (OeNB), in its role as the central bank of Austria, became part of the Eurosystem in 1999 and has since been involved in the decision-making process of the European System of Central Banks on the same footing as other national central banks.

With this special issue of the OeNB's Monetary Policy & the Economy quarterly, the OeNB seeks to take stock of Austria's first 25 years as an EU Member State, completing a trilogy of special issues dedicated to important milestones of EU membership. In 1999, when the euro was launched, Austria was well poised for euro area membership, which is contingent on EU membership. To mark Austria's 20th anniversary as an EMU member, the OeNB published a special issue on the topic of "20 years of the euro in Austria" – the second part of the trilogy – in 2019. One year earlier, in 2018, the trilogy's first part was published on the occasion of Austria's EU Presidency scheduled for the second half of 2018. Under the heading "Europe 2030: building a more resilient European monetary union," the issue explored whether the EU and the euro area had become sound and resilient enough to prevent future crises, or whether they would at least be able to handle them more adroitly.

According to economic theory findings, EU membership and, even more so, participation in the single market go hand in hand with positive growth effects and, hence, with a positive impact on income and employment. The article by Breuss shows that 25 years of EU membership have indeed had significant growth-enhancing effects on the Austrian economy, fueled by Austria's participation in the common market and monetary union, the country's intensified trade relations with its current peers as well as the momentum of EU enlargement. The author thus confirms the findings of numerous empirical studies which point to the same integration effects.

The following contribution by Stehrer looks at the impact of EU enlargement to the East on the Austrian economy. After the fall of the Iron Curtain, Austria swiftly restored and expanded its long-established trade relations with the countries of Central, Eastern and Southeastern Europe (CESEE). The enlargements of the EU further intensified Austria's economic linkages to CESEE, bringing the share of Austrian exports to the region to one-quarter. Stehrer shows that Austria's gateway position in Europe and its geographical proximity to Germany have played an important role in enabling the country to strongly benefit from rapidly growing economies in CESEE, its integration into European production chains and the ensuing emergence of specialization and agglomeration patterns within Europe.

EU accession and common market participation created new sales opportunities for Austrian businesses, which were, however, accompanied by increased competition and mounting wage pressures. These factors have had a strong impact on productivity and profit margin developments; by European standards, productivity per hour worked currently stands at above-average levels in Austria. In their article, Fenz, Ragacs, Schneider and Vondra analyze the key drivers of corporate productivity and profitability – two key indicators of corporate and economic performance – starting with Austria's entry into the EU back in 1995. Besides innovation, education and training, market efficiency as well as infrastructure, key drivers also include institutional factors, with EU/EMU membership playing a central role as well. Going into more detail, the authors examine which economic sectors and which production factors were decisive in propelling productivity growth in Austria, also shedding light on the role of structural change in this context. Based on a shift-share analysis, they find that aggregate productivity growth has been driven by the productivity gains of individual sectors, and that it has been dampened by structural change: Sectors with high productivity levels have been crowded out somewhat by

sectors with low productivity levels. On the supply side, productivity growth is attributable above all to total factor productivity. From a macroeconomic perspective, productivity gains per hour worked have been closely correlated with profit share changes in Austria.

Stiglbauer examines the impact of Austria's EU accession, which has been a catalyst for the free movement of workers within the EU, on labor market developments and the composition of labor supply in Austria. Over the past two-and-a-half decades, there has been a strong rise in the number of citizens from other EU Member States working in Austria, which has been most pronounced for citizens from countries that joined the EU in the enlargement rounds of 2004 and beyond. These employees have partly offset the decline in growth observed for Austria's working age population, which is driven by demographic aging, and have been making significant contributions to output growth in Austria. In terms of socio-economic characteristics, other EU citizens working in Austria are typically male, young and well-educated. The immigration numbers from countries that joined the EU in 2004, 2007 or 2013 can be explained with the size of the respective home countries, their geographical proximity to Austria and their per capita income levels. Within Austria, there is an east-west divide between citizens from the "new" EU Member States (i.e. the countries that joined the EU in or after 2004), who tend to work in the eastern provinces, and citizens from the "old" EU Member States, who tend to work in the western provinces. Citizens from the old EU Member States tend to hold academic or technical jobs, whereas citizens from the new EU Member States tend to be in low-skilled jobs or in services and skilled trades jobs, particularly in the hospitality industry, construction, trade and employee leasing.

Free movement of services and freedom of establishment – besides free movement of goods, capital and persons – constitute the four pillars of the EU's single market, enabling mobility of businesses and employees within the EU. However, implementation of these pillars proved difficult. It was only in 2006 that the EU's services directive was adopted to address remaining obstacles to the free movement of services within the EU. Like in other EU Member States, implementation of the services directive also suffered delays in Austria, which transferred the directive into national law in 2012. In their contribution, Kolleritsch and Walter focus on the effects of the free movement of services on the development of Austrian services exports. The main emphasis is on the development of business-related services, which are broken down by regional and sectoral aspects as well as by business-specific features like the business sector, the number of employees and specialization areas. The authors find that Austria's closer integration with the EU has reinforced domestic export relations with other EU countries but has generated only (relatively) limited growth dynamics. The pattern of domestic exports has shifted toward other euro area countries and toward non-neighboring EU accession countries. Transport services account for the largest share of business-related services exports to other EU countries, followed by technology-intensive services, which have been growing in importance. Insurance and financial services exports, by contrast, have fallen markedly as a result of the financial and economic crisis. Interestingly, services trade with non-EU countries is relatively more dominated by knowledge-based services than that with EU countries.

According to international economics, regional agreements on economic integration based on preferential trade arrangements or the creation of a common market or monetary union increase foreign direct investment (FDI) flows and stocks for both participating and third countries. Christen and Falk examine the impact of EU accession on greenfield investment relations between Austria and the EU using an FDI gravity model containing information on more than 200,000 FDI projects over the period 2003–2018. The results show that the impact of EU membership on greenfield FDI is large and significant for Bulgaria and Romania, but not significant for Croatia. In

Bulgaria and Romania, the number of greenfield FDI projects by Austrian multinational companies increased by 180% on average in the first three years after accession, with the number of resulting jobs increasing by 140%. The biggest effects already occurred one year before accession.

The opening-up of the eastern European states, EU accession and EU enlargement rounds had provided a powerful stimulus for Austria's banking sector. As Kavan and Wittenberger show in their contribution, Austria's major banks jumped at the opportunity of expanding their low-margin domestic operations by entering CESEE markets soon after the fall of the Iron Curtain. By establishing new banks and/or acquiring existing banks, they were able to rapidly gain a foothold in the region and benefit from the reform mood and growth momentum fueled by the prospect of potential EU membership for CESEE countries. Dynamic loan growth generated high profits, but the rapid expansion was not without downsides. Much of the lending occurred in foreign currencies and was refinanced by the parent banks. The underlying risks materialized at the onset of the global financial and economic crisis, leading to a period of consolidation and the implementation of macroprudential measures designed to mitigate risks to financial stability in the future. The economic catching-up process in Austrian banks' enlarged home market continues to provide the potential for significant growth and profits; yet, it also comes with persisting challenges for banking supervision.

Cross-border operations on the common market necessitate a single set of European regulatory measures ensuring a level playing field for all businesses, financial institutions and other economic agents. This holds for both the real economy and the financial sector, with the latter also being subject to regulatory aspects of financial stability in a monetary union (apart from competitive aspects). When Austria joined the EU, EU legislation on banking regulation was still highly fragmented, and EU-wide harmonization – also as regards banking supervision – was still in its formative years. Kaden, Boss and Schwaiger highlight the harmonization measures adopted since the introduction of the single rulebook on prudential regulation and the drive for more and deeper financial market regulation as a consequence of the 2008–2009 financial crisis. The authors show that the setting up of banking union has led to increased convergence in the operational arm of banking supervision within the euro area. These developments, which improve banks' risk management policies and raise the banking system's risk-bearing capacity, have made the banking sector more resilient than it was 25 years ago – both at EU and domestic level. At the same time, significant progress has been achieved in creating a more level playing field in the European banking sector.

Austria's accession to the EU has also left its mark on domestic competition policies. Competition policies to ensure the viability of the common market are among the policy priorities for the European Union. Indeed, the proper functioning of the Union's internal market would be unthinkable were it not for EU competition rules, which aim to prevent distortions of competition. Based on cartel, merger and state aid controls, these rules serve to restrict unfair practices, such as illegal contacts and agreements, price fixing and market sharing. Ultimately, EU competition rules aim to create equal opportunities for all competitors in the internal market – also for small and medium-sized businesses, employees and consumers. In his contribution, Böheim looks back at 25 years of competition policymaking in Austria, illustrating that competition policies did not play a noteworthy role for many years. The adoption of the *acquis communautaire* on competition law and the supremacy of Union law finally created sufficient external pressures for Austria to align, with some delay, the relevant material rules of domestic law with Union law and to redesign the institutional governance of competition. However, there is a case for strengthening the role of relevant institutions, i.e. for giving the Competition

Commission a more prominent role as a competent authority for independent advice for competition policymaking.

With regard to inflation developments in Austria, the article by Messner and Rumler aims to identify if and how the inflation process has changed in Austria in the past 25 years in line with the changing economic framework, including Austria's accession to the EU, participation in EMU, the globalization of the economy and the financial and economic crisis. The authors' findings yield a stable Phillips curve for Austria over several decades. In other words, they find inflation to have been positively correlated with economic activity, subject to a temporary weakening of this relationship during the 1990s. During that period, the impact of external factors on domestic inflation, such as Austria's EU accession, EMU implementation and globalization, is likely to have increased. The authors also come to the conclusion that monetary policy did not start to have a measurable impact on inflation developments in Austria until the establishment of EMU.

Finally, Austria's accession to the EU also brought about significant direct fiscal effects, as Austria is required to contribute to the financing of the EU budget, while profiting at the same time from budget returns. The EU budget is the balance of fiscal flows within the EU and a reflection of the EU's policy priorities. These priorities have changed significantly in recent decades, as is evidenced above all by the scope of the EU's multiannual financial framework. Negotiations over the financial framework for the 2021–2027 period, which have been ongoing since 2018, clearly point to the major political challenges involved in finding common ground among the Member States' conflicting interests, a prerequisite to reach a unanimous decision on the next budget. Köhler-Töglhofer and Reiss evaluate the main policy priorities for the EU by taking a closer look at the changes in the EU budget's expenditure and funding patterns. In recent decades, the latter have shifted and increased in complexity, as numerous budget correction mechanisms were introduced to adjust contributions from net paying Member States to the EU budget. Austria has been a net contributor ever since it joined the EU in 1995, but it has also been benefiting from rebates for net paying Member States. Austria has, moreover, been receiving more money back through agricultural subsidies than other EU countries with high per capita levels of gross national income. Thus, a too narrow focus on the amount of net contributions to the EU budget risks losing sight of the significant economic benefits of the single market on small open economies like Austria.

EU accession and EMU participation, in particular, are pertinent to all processes involved in economic policymaking in Austria. The impact of the monetary and fiscal policy framework and the resulting effects of the Eurosystem's single monetary policy on the Austrian economy were addressed in the OeNB's 2019 special issue on "20 years of the euro in Austria." In the present special issue, Auböck and Prammer discuss the coordination of EU Member States' economic and structural policies with a special emphasis on related country-specific recommendations for Austria. The EU's broad economic policy guidelines, issued annually since 1993, have been aimed at coordinating EU Member States' economic and fiscal policies – initially with a view to putting the functioning of EMU on a solid footing. Economic policy coordination was supposed to help offset imbalances emerging between economically stronger and weaker euro area countries which could no longer rely on the exchange rate as a correction mechanism. Moreover, the coordination of Member States' economic and structural policies was supposed to curb highly divergent wage and price developments among Member States as well as opposing developments in competitiveness and resulting macroeconomic imbalances. However, the global financial and economic crisis laid bare existing internal and external macroeconomic imbalances, which led to a reform not only of the EU's coordination mechanism but also of its entire governance

framework. The newly created instrument of macroeconomic surveillance is now used to set the economic policy priorities under the European Semester, which serve as the basis for country-specific recommendations for each Member State. This is also the case for Austria, which has typically received policy guidance to shift taxes away from labor, ensure the long-term sustainability of its pension system, improve its educational system, provide more effective incentives to unlock untapped labor market potential and boost competition (especially in the service sector). However, since Member States are not legally bound to implement the country-specific recommendations, implementation rates are often low – and Austria is no exception in this respect.

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The EU countries, including Austria, have not been left unscathed by the deep global recession induced by measures to contain the COVID-19 pandemic, which has made the world acutely aware of the fact that such shocks do not stop at national borders. Finding the right health care and economic policy responses poses a major challenge and constitutes a veritable stress test for the quality of decision-making and the robustness of public institutions. In such turbulent times, policy responses are bound to be taken based on limited available information, amid a high degree of uncertainty and under extraordinary time constraints. Looking back, the measures taken hardly ever seem ideal. Yet, what matters, be it for Austria or the EU, is how well the decisions taken under the most difficult of conditions and amid great uncertainty will have worked for our circumstances, how resilient public health care and the economy will have proven to be and what long-term implications will have arisen for the economy, society and the performance of public institutions.

The crisis is far from over and it will take quite some time before conclusive answers to these questions may be found. Nevertheless, at the editorial close of this issue at end-June 2020, the signs were pointing to the EU being in a better position to successfully overcome the health crisis than other parts of the world, including developed economies like the U.S.A or the United Kingdom. The ECB took swift and decisive action, and thus prevented an even sharper economic setback, kept the European economy from slipping into deflation and guaranteed the stability of the financial system. Owing to tightened EU-wide regulations and increased capital buffers since the global financial crisis, European banking systems have proven to be much more resilient in the face of the current shock and to be capable – supported by government action – of providing loans to the economy, helping the latter get through the crisis. Moreover, the EU Member States reacted decisively and pointedly by swiftly launching much needed support programs for businesses, employees and specific sectors on a grand scale. This includes the pragmatic decision to allow for more flexibility by temporarily suspending the EU's fiscal rules.

Last but not least, substantial common relief funds were allocated at EU level, the details of which ought to be agreed over the summer of 2020. These newly established funds, which are being set up as a temporary response to the COVID-19 crisis, put down a significant marker for the EU's resolute action and political will to further deepen EU integration and advance EMU.

It is precisely in times of crisis that the advantages of EU and EMU membership for small open economies like Austria become particularly evident. History has shown that the EU has proven surprisingly resilient time and again, demonstrating its ability to evolve and to tackle even highly demanding challenges despite initial differences in interests. The EU's democratic procedures, i.e. its commitment to an open dialogue and willingness to reach agreement through negotiation, provide the basis for its success – both in an economic and a broader social context. As an EU

member, Austria will continue to benefit from the EU's common strength and problem-solving abilities and continue to contribute to the Union's further development for the good of all members.

Ernest Gnan  
Walpurga Köhler-Töglhofer  
Doris Ritzberger-Grünwald

# Macroeconomic effects of 25 years of EU membership for Austria

Fritz Breuss

Austria, together with Finland and Sweden, joined an EU with 12 Member States 25 years ago, thereafter participating in the EU's expansion to 28 Member States until 2013 and its shrinking to 27 countries in the context of Brexit. Even before joining the EU, Austria had aligned its trade policy with the EU as a member of the European Free Trade Association through a Free Trade Agreement with the European Community in 1973 and through participation in the European Economic Area in 1994. Upon joining the EU, Austria entered the single market, receiving and granting the four freedoms of movement for goods, services, capital, and labor. Subsequently it participated in all steps of deepening the Union. Among other things, Austria was among the eleven countries that founded the Economic and Monetary Union (EMU) in 1999 and introduced the euro as legal tender in 2002, i.e. ahead of some of today's 19 euro area countries. Austria joined the Schengen Agreement on April 28, 1995, which led to the abandonment of border controls on April 1, 1998. The EU enlargement rounds from 2004 onwards reinforced the benefits Austria had already reaped from the opening-up of Eastern Europe in 1989.

Comparing Austria's economic performance with Finland and Sweden in the last 25 years, we find the Scandinavian countries in the lead with regard to most macroeconomic indicators: Real GDP grew around 2% per annum in Finland and Sweden, compared with 1.6% in Austria. Austria, Finland, and Sweden are, thus, among the richest EU Member States. In terms of GDP per capita, Austria was the second-richest country in the EU-15 in 1995, with Finland in tenth place and Sweden in fifth. In 2020, Austria ranked third in the EU-27, Finland seventh and Sweden sixth. Since EU accession, Austria has had a higher inflation rate (1.8%) than Finland (1.4%) and Sweden (1.2%). Concerning the fiscal stance (budget deficit and public debt) and the current account, Austria has been outperformed by both Scandinavian countries. In contrast, Austria has done better in terms of unemployment. At 4.8%, the unemployment rate was on average much lower than in Finland (9.1%) and Sweden (7.6%) in the past 25 years.

Given the better overall economic development in Finland and Sweden compared to Austria, it is surprising that almost all studies assessing the effects of EU membership in the three countries are less favorable for the Scandinavian countries than for Austria. The welfare and GDP effects are only half as large as in Austria. One reason for this result may be the fact that most studies justify the EU effects solely with an increase of intra-EU trade. In this respect, Austria has a two-fold advantage: intra-EU trade developed not only more dynamically for Austria than for Finland and Sweden in the past 25 years, it also has a higher share of intra-EU trade, namely 70.8% compared with 58.8% for Finland and 57.9% for Sweden.

The integration model for Austria discussed in Breuss (2020) includes several effects likely to have been fueled by EU integration: (1) Trade and foreign direct investment increased after full participation in EU's single market and was enhanced through EU enlargement in 2004; (2) EMU and the introduction of the euro increased Austria's relative competitiveness against countries at the periphery which devaluated against the Deutsche mark and also against the Austrian schilling in the pre-euro area; (3) Productivity increases due to an increasing participation in EU research programmes; (4) More competition in the single market reduced price mark-ups in Austria; (5) Austria is a net contributor to the EU budget, contributing 0.25% of gross national expenditure

on average; 6) Net immigration was limited after EU accession in 1995 and its increase after the EU enlargement in 2004 was cushioned by seven years of transitional arrangements.

This assessment of 25 years of Austria's EU membership yields an overall positive balance of 25 years EU membership, even if apparently overshadowed by the coronavirus crisis of 2020. On average, EU accession gave Austria a real GDP growth dividend of 0.8 percentage points per year since 1995. In line with three stages of EU integration, this amount can be mapped to three effects: 0.4 percentage point of GDP growth due to participation in the EU's single market, 0.1 percentage point of GDP growth from EMU/euro participation and finally 0.3 percentage point of GDP growth due to the EU enlargement rounds since 2004.

On top of that, important seeds of growth were planted already with the fall of the Iron Curtain in 1989 and the following opening-up of Eastern Europe. This historic event moved Austria politically and economically from the border to the center of Europe. Austria quickly took advantage of these new opportunities for trade and foreign direct investment, certainly benefiting from memories of the old Austro-Hungarian monarchy. Austria's opening up toward the east led to an annual increase in real GDP of around 0.1 percentage points.

This bright picture is, however, clouded by the presumption that the best years of Austrian EU membership appear to be behind us. Significant new integration impulses in the near future for Austria's economy are highly unlikely for four reasons: (1) The hitherto strong growth impulses from the new EU Member States in Eastern Europe will peter out. (2) Even if the euro were to be introduced by all remaining EU Member States, the additional growth effect would be modest because the potential new members are all smaller countries. (3) The possible costs associated with the final Brexit – be it hard or soft – should not be underestimated not only in terms of losses of GDP but also because of the loss of a net contributor to the EU budget. (4) The coronavirus crisis will not only cause the deepest recession since World War II in 2020, but it could also – despite the EUR 750 billion EU recovery plan – significantly slow down the European integration process in the years to come.

**Breuss, F. 2020.** Makroökonomische Effekte der 25-jährige EU-Mitgliedschaft Österreichs. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 27–48.

# Convergence, production integration and specialization patterns in Europa since 1995

Robert Stehrer

Austria's development since its accession to the EU on January 1, 1995, has to be seen as an integral part of the beginning European integration process following the opening up of Eastern Europe. Essential aspects of this integration process were the restructuring and catching-up processes of the Eastern European countries, their integration into European and global value chains and the corresponding development of trade flows and foreign direct investment, as well as the resulting development of specialization and agglomeration patterns within Europe. In the context of EU accession, Austria's geographical but also political position between West and East thus represented both a great challenge and an opportunity. This study traces Austria's development along these dimensions in a European context and discusses the resulting future challenges.

First, the paper argues that Austria's economic development after joining the European Union 25 years ago is strongly intertwined with other important political and economic events in Europe, which acted as a catalyst. These events range from economic dynamics in European countries, political crises and wars in the EU's neighbourhood to global developments such as the rise of emerging economies as China. In recent years, populist movements and disintegration tendencies – up to the painful withdrawal of Great Britain from the Union in January 2020 – have gained momentum.

Second, the study then points out that Austria has by and large performed well in this – not always harmonious – concert of European development since accession in 1995, both in general and in direct comparison with peer countries such as the neighbouring countries Germany and Italy, but also Sweden and Finland, which joined the EU at the same time as Austria. Specifically, Austria was able to broadly maintain its relative position in terms of GDP per capita in the EU-28. Austria's relative income position changed from 31 percentage points above the EU-28 average to 28 percentage points. In comparison, the position of the EU-15 (relative to EU-28) as a whole decreased in relative terms by about 10 percentage points (from about 117 to 107).

Third, it is argued that Austria's central location in Europe and its geographical proximity to Germany played an important role in this respect, enabling Austria to benefit from the rapidly growing economies in Eastern Europe, their integration into European production networks and the resulting patterns of the European division of labor, i.e. the agglomeration and specialization trends. And Austria indeed took advantage of these opportunities. One of the reasons for Austria's good performance is its strong integration into European and global value chains, due in part to Austria's central geographical location in the heart of Europe and its solid economic starting position. The share of Austrian exports in the gross domestic product rose from slightly more than 30% in 1995 to about 55% in 2019, i.e. by about 25 percentage points. However, since gross exports also include imported inputs, this figure overestimates the effect on the overall economic income. Analogously, the share of value added exports in GDP was 24% in 1995 and rose to 33% in 2014, an increase of 9 percentage points. This widening gap between the ratio of gross exports and value added exports to GDP results from the increasing use of imported inputs in production.

In this context, this paper shows that the long-term growth rate of per capita income for Austria is above the average of similarly rich countries and that domestic firms have been able to integrate well into the emerging European production networks, which are important for Austria. In particular, this meant that the share of manufacturing in value added remained high compared to other countries and that the share of business-related services also increased, while remaining below the average of comparable countries.

In sum, Austria's EU membership was certainly an important "catalyst" in this environment, which in some cases changed rapidly during this phase and in fact continues to be in a state of flux and has been or will be shaped by membership. Looking ahead, the only constant variable will be the need to keep adjusting, to be able to counter the medium and long-term challenges that are emerging as a result of technological (e.g. digitization) and demographic developments (e.g. population decline in various European countries, aging, migration) – apart from various scenarios concerning the European project as such. The European Commission is committed to prepare for the impact of the COVID-19 pandemic and its economic consequences, potential geopolitical trends (e.g. trade disintegration, China's rise to a world power, conflicts in the European neighbourhood) and looming environmental challenges.

**Stehrer, R. 2020.** Konvergenz, Produktionsintegration und Spezialisierung in Europa seit 1995  
In: Monetary Policy & the Economy Q1–2/2020. OeNB. 49–59

# Development of corporate productivity and profitability in Austria during EU membership

Gerhard Fenz,  
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Austria's development since its accession to the EU on January 1, 1995, has to be seen as an integral part of the beginning European integration process following the opening up of Eastern Europe. Essential aspects of this integration process were the restructuring and catching-up processes of the Eastern European countries, their integration into European and global value chains and the corresponding development of trade flows and foreign direct investment, as well as the resulting development of specialization and agglomeration patterns within Europe. In the context of EU accession, Austria's geographical but also political position between West and East thus represented both a great challenge and an opportunity. This study traces Austria's development along these dimensions in a European context and discusses the resulting future challenges.

First, the paper argues that Austria's economic development after joining the European Union 25 years ago is strongly intertwined with other important political and economic events in Europe, which acted as a catalyst. These events range from economic dynamics in European countries, political crises and wars in the EU's neighbourhood to global developments such as the rise of emerging economies as China. In recent years, populist movements and disintegration tendencies – up to the painful withdrawal of Great Britain from the Union in January 2020 – have gained momentum.

Second, the study then points out that Austria has by and large performed well in this – not always harmonious – concert of European development since accession in 1995, both in general and in direct comparison with peer countries such as the neighbouring countries Germany and Italy, but also Sweden and Finland, which joined the EU at the same time as Austria. Specifically, Austria was able to broadly maintain its relative position in terms of GDP per capita in the EU-28. Austria's relative income position changed from 31 percentage points above the EU-28 average to 28 percentage points. In comparison, the position of the EU-15 (relative to EU-28) as a whole decreased in relative terms by about 10 percentage points (from about 117 to 107).

Third, it is argued that Austria's central location in Europe and its geographical proximity to Germany played an important role in this respect, enabling Austria to benefit from the rapidly growing economies in Eastern Europe, their integration into European production networks and the resulting patterns of the European division of labor, i.e. the agglomeration and specialization trends. And Austria indeed took advantage of these opportunities. One of the reasons for Austria's good performance is its strong integration into European and global value chains, due in part to Austria's central geographical location in the heart of Europe and its solid economic starting position. The share of Austrian exports in the gross domestic product rose from slightly more than

30% in 1995 to about 55% in 2019, i.e. by about 25 percentage points. However, since gross exports also include imported inputs, this figure overestimates the effect on the overall economic income. Analogously, the share of value added exports in GDP was 24% in 1995 and rose to 33% in 2014, an increase of 9 percentage points. This widening gap between the ratio of gross exports and value added exports to GDP results from the increasing use of imported inputs in production.

In this context, this paper shows that the long-term growth rate of per capita income for Austria is above the average of similarly rich countries and that domestic firms have been able to integrate well into the emerging European production networks, which are important for Austria. In particular, this meant that the share of manufacturing in value added remained high compared to other countries and that the share of business-related services also increased, while remaining below the average of comparable countries.

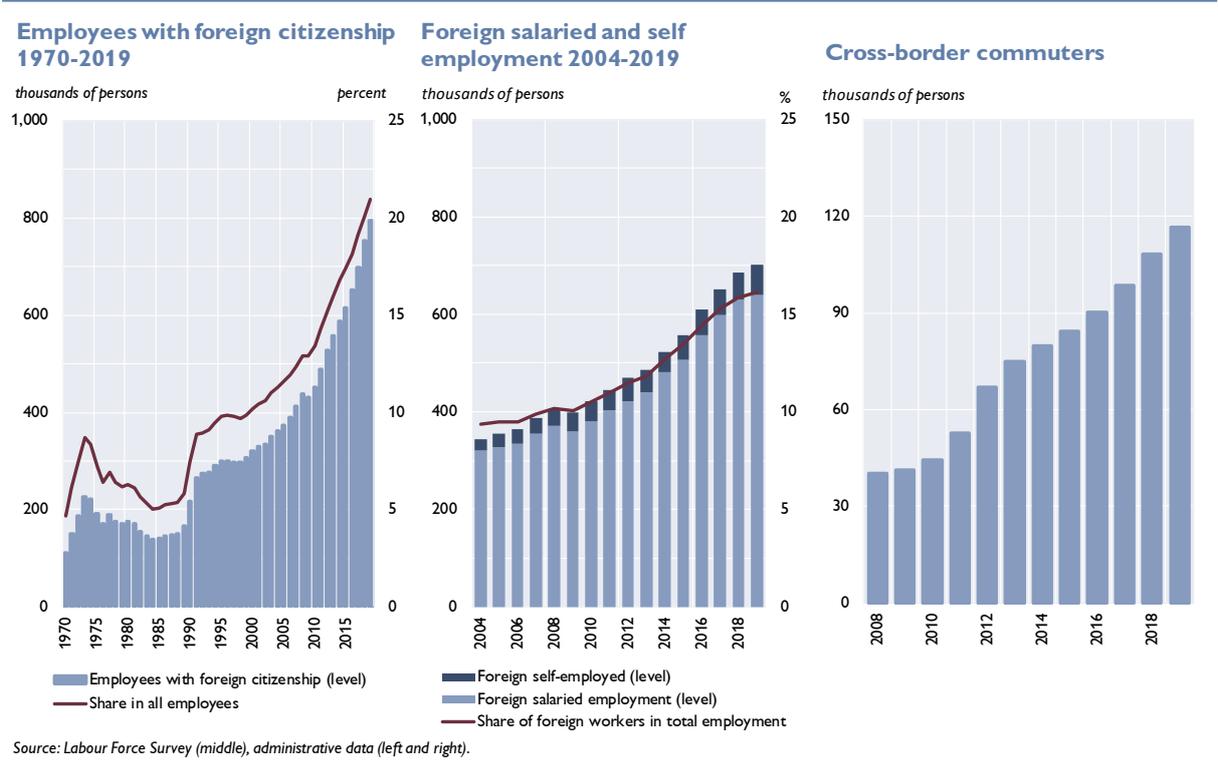
In sum, Austria's EU membership was certainly an important "catalyst" in this environment, which in some cases changed rapidly during this phase and in fact continues to be in a state of flux and has been or will be shaped by membership. Looking ahead, the only constant variable will be the need to keep adjusting, to be able to counter the medium and long-term challenges that are emerging as a result of technological (e.g. digitization) and demographic developments (e.g. population decline in various European countries, aging, migration) – apart from various scenarios concerning the European project as such. The European Commission is committed to prepare for the impact of the COVID-19 pandemic and its economic consequences, potential geopolitical trends (e.g. trade disintegration, China's rise to a world power, conflicts in the European neighbourhood) and looming environmental challenges.

**Fenz, G., C. Ragacs, M. Schneider und K. Vondra. 2020.** Entwicklung von Produktivität und Profitabilität heimischer Unternehmen während der EU-Mitgliedschaft. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 60–74

# EU membership, EU enlargement and its consequences for the Austrian labor market

Alfred Stiglbauer

Since Austria’s accession to the EU, employment of other EU nationals has risen strongly – especially with regard to workers from the newer Member States (EU accession in or after 2004) who obtained access to the Austrian labor market after a transition period, starting in 2011. This has led to a surge in the share of foreign workers, including cross-border commuters (see chart).



EU nationals working in Austria have mitigated the demographically induced slowdown in the growth of the working age population and made a considerable contribution to employment and economic growth in Austria. Workers from the newer Member States mostly come from Hungary, Romania, Poland or Slovakia. Quantitative analysis based on the gravity model shows that immigration to Austria can be well explained by the size of the countries of origin, the average distance and the average income.

EU nationals working in Austria are typically male and relatively young. Workers from the older EU Member States tend to work in Western Austria and in Vienna, whereas nationals from the newer EU Member States tend to work in Eastern Austria. Nationals from the older EU Member States work mainly in manufacturing, trade, hotels and restaurants, in the professional, scientific and technical services and in other economic services. Workers from the newer Member States typically work in hotels and restaurants, as temporary workers, in the construction industry and in trade. On average, EU nationals working in Austria (older and newer EU Member States alike)

have higher educational qualifications than Austrian nationals. However, while workers from the older EU Member States are mainly employed in academic and technical professions, those from the newer EU Member States are primarily employed as unskilled workers and in service and craft professions.

Estimates, based on micro data from the Labour Force Survey, of whether immigration from the newer EU Member States has increased the risk for domestic workers to enter unemployment indicate a mere marginal increase. This result is robust to different specifications, to changes in subperiods and to whether an instrument-variable estimation is employed. Additional tests show that for some groups (manual workers, manual laborers and especially workers in services and sales) this effect is greater than on average.

EU nationals will continue to contribute to the growth of the Austrian labor force potential. However, rising income levels in the newer EU Member States are likely to reduce the growth in employment from these countries. Only in the case of Croatia is the opening of the Austrian labor market likely to lead to higher immigration in the medium term.'

**Stiglbauer, A. 2020.** EU-Mitgliedschaft, EU-Erweiterung und die Auswirkungen auf den österreichischen Arbeitsmarkt. *In: Monetary Policy & the Economy Q1-2/2020. OeNB. 75–88.*

## Free movement of services within the EU's Single Market: what have been the effects on Austria?

Erwin Kolleritsch,  
Patricia Walter

Free movement of services and freedom of establishment – besides free movement of goods, capital and workers – constitute the four pillars of the EU's single market, enabling mobility of enterprises and employees within the EU. In our analysis, we focus on the effects of the free movement of services on the development of Austrian services exports over the last 25 years. In addition, we explore how this development impacted value added in Austria. The main emphasis is on the development of business-related services, while travel as a component of private consumption is only considered for comparisons. We analyze the development of services exports under regional and sectoral aspects and we account for business-specific features like the business sector, the number of employees and specialization areas (mere services exporters or exporters of goods as well as services). Based on these major trends, we explore the total effects of business-related services exports on Austrian value added by applying input-output analysis.

Ebell (2016) sees substantial and statistically significant growth in bilateral trade in services as an effect of EU membership, depending on the depth of the trade agreement. In principle, implicit trade restrictions (“intangible goods”) as well as tariff or physical restrictions (in transportation) and nontariff trade restrictions (differing regulations for financial, juridical and economic services) are more important in trade in services than in trade in goods (Ebeke et al., 2019; Borchert et al., 2012). Yet, the EU's single market is the farthest-reaching trade agreement worldwide. Remaining obstacles to the free movement of services within the EU were addressed with the adoption of the services directive in 2006, which among others provided for administrative simplification, interstate cooperation and the abolishment of unjustified restrictions for trading services across borders and establishing a commercial presence abroad. However, implementation of the services directive suffered delays (Austria started applying the directive in 2012) and remains, according to the European Commission (2017), incomplete. For Austria, Francois et al. (2008) have simulated the possible effects of liberalization of trade in services and find positive trade effects and a shift towards trade relations within the EU. Based on these findings, Fritz and Streicher (2008) have calculated little effect on Austrian gross value added.

We find that Austria's closer integration with the EU has reinforced domestic export relations with other EU countries but has generated only (relatively) limited growth dividends. The pattern of domestic exports has shifted toward other euro area countries and (beyond Austria's immediate borders) toward EU accession countries. Besides implicit trade restrictions, the development has been driven by less than full implementation of the single market, early efforts to build trade relations with Central, Eastern and Southeastern European economies and Austrian businesses' propensity to take up the freedom of establishment within EU borders. While services exports within the EU are relatively more important for Austria than for comparable EU countries, the comparative advantages Austria has gained from these exports are limited. Our results suggest that services trade within the EU is relatively more important for small businesses and Austrian-dominated companies, while trade with non-EU countries is relatively more dominated by knowledge-based services and exports of manufacturing companies. Over time, the share of value

added by Austrian services exports to the EU has been rising, but the corresponding final demand multipliers continue to be smaller than for exports to non-EU countries.

**Kolleritsch, E. und P. Walter 2020.** Freizügigkeit des Dienstleistungsexports im EU-Binnenmarkt und Effekte auf die österreichische Wirtschaft. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 89–109.

# EU integration and its impact on the development of greenfield FDI

Elisabeth Christen,  
Martin Falk

*Empirical studies agree that EU membership and the creation of the European Single Market in 1992 increased FDI flows and stocks for the participating countries. However, it is likely that the FDI effect of economic integration will decrease over time as the number of EU Member States increases. This paper examines the impact of EU accession on greenfield investment between Austria, the EU, selected non-EU source countries and the new Member States, Bulgaria, Romania and Croatia. A distinction is made between sectors (services and manufacturing). The impact is estimated using an FDI gravity model containing information on 200,000 FDI projects over the period 2003-2018. The results show that the impact of EU membership on greenfield foreign direct investment is large and significant for Bulgaria and Romania, but not significant for Croatia. In particular, the number of greenfield FDI projects by Austrian multinational companies in Bulgaria and Romania increased by 180% on average in the first three years after accession, with the effects already occurring one year before accession. The results do not differ much between services and manufacturing.*

Theoretical considerations suggest that regional economic integration agreements through preferential trade arrangements, EU membership and monetary integration lead to an increase in foreign direct investment (FDI) – both for participating countries and third countries. As indicated by the empirical literature, the milestones of European economic integration (the Single European Act of 1987, the creation of the Single European Market in 1992 and the enlargement of the EU in 1995, 2004 and 2007) were indeed accompanied by both an increase in intra-EU FDI and increased FDI flows from third countries (Brenton et al., 1999; Baltagi et al., 2008; Bevan and Estrin, 2004; Straathof et al., 2008; Narula and Bellak, 2009). For example, gravity model estimates by Straathof et al. (2008) yield a 14% increase of direct investment stocks from non-EU countries following EU membership, and a 28% increase from other EU Member States.

This study provides a first assessment of the impact of Croatia's accession to the EU on foreign direct investment compared to other EU accession countries (Bulgaria and Romania). For this purpose, we estimate an FDI gravity model for greenfield FDI from 30 EU/OECD source countries to 50 destination countries. The literature on the determinants of FDI based on gravity equations is extensive (Chakrabarti, 2001; Fratianni et al., 2011; Zwinkels and Beugelsdijk, 2010). More recent studies examining FDI determinants for EU countries have been conducted by Wolff (2007) and Bénassy-Quéré et al. (2007). However, few studies have examined the determinants of greenfield direct investment. The main contribution of this paper is a detailed empirical analysis of the effects of EU membership on greenfield direct investment.

We complement the basic FDI gravity model with corporate taxes in the target country, GDP per capita and economic growth in the source and target countries. Furthermore, we estimate the FDI gravity equation using a counting data model with bilateral (fixed) effects, representing the possible role of geographical distance, but also other factors such as labor costs and other cost-based factors, corporate and payroll taxes, skills, technological infrastructure and FDI regulations. Moreover, this estimation method considers the fact that for some source and destination countries, zero direct investment is recorded (Santos Silva and Tenreyro, 2006).

The information on greenfield investments comes from the fDi Markets database, which contains information on around 200,000 investment projects worldwide for the period from 2003 to 2018, as available from media sources. The data on greenfield direct investments are partly estimated

and can be interpreted as investment intentions. They have advantages and disadvantages compared to official direct investment data, which have been viewed increasingly critically in the literature (e.g. Beugelsdijk et al., 2010). The individual FDI project data are aggregated by source and destination country. The final data set consists of bilateral greenfield direct investments from 30 source countries in 52 destination countries (including EU Member States and the remaining industrialized countries) for the period 2004 to 2018. For the gravity equation, the total number of possible combinations is 21,840 (14 years x 30 source countries x 52 destination countries).

For Bulgaria and Romania, the estimated results show that EU accession in 2007 led to a sharp increase in greenfield direct investment between the new and existing EU Member States. This is especially true for Austrian investments in Bulgaria and Romania as well as for those from other EU countries, but to a lesser extent also for those from non-EU countries. It is noteworthy that the effects already occurred one year before EU accession and lasted for several years. On average, the number of greenfield direct investment projects by Austrian multinationals increased by 180% in the first three years after Bulgaria and Romania joined the EU, and by 280% in the year of accession. If all EU countries of origin are considered, the magnitude of the effect is about 50% per year on average. The increase in greenfield direct investment after EU accession is lower when only the non-EU countries are considered (+16% on average per year). The direct investment effect tends to decrease over time after EU accession. In the case of Austrian greenfield direct investments, however, the effect is still significant at the 5% level even after three years. The extent of the impact of Bulgaria and Romania's EU membership on greenfield FDI is significantly higher than in the studies that consider total FDI (stocks and inflows) (Bruno et al., 2016).

For Croatia, the estimations do not yield an intensification of bilateral greenfield direct investment upon EU accession except for the surge in the number of greenfield direct investment projects run by Austrian multinational companies in 2012. However, this was not reflected in an increase of jobs, and the following years were even characterized by negative effects. This could indicate a weakening of the impact of EU membership on greenfield direct investment as the number of EU member states increases. Another explanation could be related to target country characteristics. The question is not easy to answer and must be considered separately for both enlargement rounds and new member states. Whether these results are transferable to future EU members cannot yet be conclusively assessed. It is still open whether these effects can also be demonstrated for total direct investment or for other direct investment indicators (e.g. employment in subsidiaries). In future work, the gravity model could be extended by additional explanatory factors (wage costs, availability of qualified labour, location factors), or the estimates could be carried out for different subsectors. However, the very low number of greenfield direct investment projects in Croatia limits the meaningfulness of further differentiation.

**Christen, E. und M. Falk 2020.** Auswirkungen der EU-Mitgliedschaft auf ausländische Greenfield-Direktinvestitionen. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 110–121.

# Austrian banks' expansion to Central, Eastern and Southeastern Europe<sup>1</sup>

Stefan Kavan,  
Tina Wittenberger

Austria's large banks jumped at the opportunity of expanding their low-margin domestic operations by entering Central, Eastern and Southeastern European (CESEE) markets soon after the Iron Curtain was lifted in 1989. The very first countries in which Austrian banks started their business were Czechia, Hungary, Poland, Slovakia and Slovenia, and later on (among others) Bulgaria, Croatia as well as Romania. By establishing new banks and/or acquiring existing ones, Austrian banks were able to rapidly gain a foothold in the region and benefit from the reform mood and growth momentum fueled by the prospect of potential EU membership for CESEE countries.

The expansion started in 1989 and gained substantial momentum in the years from 2005 to 2008, as CESEE economies – and hence banking activities – were prospering. Dynamic loan growth generated high profits, but the rapid expansion was not without downsides. Much of the lending occurred in foreign currencies and was refinanced by the parent banks. The underlying risks materialized when the global financial and economic crisis hit the region in 2009 and drove up (risk) costs, thus leading to a period of consolidation that lasted until 2015.

Macroprudential measures designed to mitigate risks to financial stability were an important lesson learned by banking supervisors from the crisis, and Austria was no exception in this respect. As a first risk-mitigating measure, the Oesterreichische Nationalbank (OeNB) and the Austrian Financial Market Authority (FMA) published guidance for banks on foreign currency lending to CESEE households in 2010. This was followed in 2012 by OeNB and FMA supervisory guidance on strengthening the sustainability of the business models of large internationally active Austrian banks, urging them to strengthen the local stable funding base of their subsidiaries, while ensuring that future credit growth would not become excessive. Furthermore, the OeNB and FMA implemented a systemic risk buffer in 2016 at the parent level, with a view to addressing systemic vulnerabilities and in particular the systemic concentration risk arising from Austrian banks' CESEE exposures.

With the economy in CESEE recovering again, the past few years until 2019 have been characterized by an enhanced ability of clients to pay back their loans. However, good profits have also been a consequence of re-accelerating credit growth, which has created new systemic challenges and necessitated macroprudential measures in several CESEE countries (e.g. the activation of the countercyclical capital buffer and/or borrower-based measures regarding mortgage lending).

At the time of writing, profitability and loan quality were good. Three decades after the fall of the Iron Curtain and 16 years after the EU accession of the first CESEE countries, the economic

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<sup>1</sup> *Disclaimer: This study analyzes Austrian banks' expansion to Central, Eastern and Southeastern Europe (CESEE) from 1989 to 2019. Hence, it does not cover developments in light of the COVID-19 pandemic.*

catching-up process in Austrian banks' enlarged home market continues to provide the potential for significant growth and profits. Yet, the long recovery driven by credit growth and the impact of the COVID-19 pandemic come with numerous challenges, which banks and their supervisors will have to address.

**Kavan, S. und T. Wittenberger. 2020.** Die Expansion der österreichischen Banken nach Zentral-, Ost- und Südosteuropa In: Monetary Policy & the Economy Q1–2/2020. OeNB. 122–134.

# The European banking supervisory framework and its institutional arrangements since Austria's accession to the European Union

Michael Kaden,  
Michael Boss,  
Markus Schwaiger

The European banking supervisory framework has changed fundamentally over time with regard to the objectives pursued, the legislative approaches adopted and the institutional arrangements used, and last but not least also with regard to the scope of regulation and supervision.

When Austria joined the European Union (EU) on January 1, 1995, the goal of establishing a single market was paramount. Policymaking was focused on removing obstacles to the freedom to provide services and the freedom of establishment, and on ensuring a level playing field across all Member States. Specific amendments to EU legislation in this regard were laid down in a range of EU directives, usually without providing for supporting institutional arrangements.

At the turn of the new millennium, the focus shifted toward facilitating faster and more flexible regulation processes by setting up European regulatory agencies for banking, insurance and securities market supervision. This change was motivated by the urge to address emerging developments in financial markets in a timely manner and to advance financial integration to be able to gain higher benefits from monetary union.

In parallel, EU legislators made an effort to stop adding to what was perceived as a flood of overly detailed legislation by putting “better regulation” principles at the heart of policymaking processes. A significant development at that time was the adoption of the Banking Consolidation Directive (BCD) relating to the taking up and pursuit of the business of credit institutions. Providing for the first ever partial codification of the European regulatory framework for banking supervision, the BCD replaced the fragmented framework of directives that had been in force up until that point.

To implement the Basel II framework published between 2004 and 2006, the European legislator subsequently amended and recast the BCD and the Capital Adequacy Directive (known as the CRD I package). Achieving an integrated European financial services market – and removing the obstacles standing in the way of this goal – remained the main driving force behind the CRD I package, which was, in fact, among the first attempts to live up to the spirit of “better regulation.”

The 2007 financial crisis, finally, significantly altered the motivation for regulation and hence the scope of the supervisory framework. Without abandoning earlier goals, EU law-making has since been dominated by efforts to address the regulatory deficiencies uncovered by the crisis and to prevent such crisis scenarios from re-emerging. In November 2008, the European Commission appointed an expert group chaired by Jacques de Larosière to make recommendations on navigating the course out of the crisis and on avoiding crises in the future. The final report submitted in February 2009, named the “*de Larosière Report*,” analyzed the causes of the crisis and offered a total of 31 recommendations for addressing shortcomings in the European regulatory and supervisory framework, underlined by two strategic objectives. The first was to make banks more resilient and therefore reduce the likelihood of crises in the banking sector, and the second was to contain the systemic damage caused by banking crises as far as possible, thus minimizing the costs to the public purse. At the institutional level, the de Larosière Report recommended

developing a decentralized network of competent supervisory authorities (European System of Financial Supervision – ESFS).

In September 2009, the CRD II package was adopted, containing – in addition to measures planned prior to and independently of the de Larosière Report – the initial responses to the crisis.

In November 2010, the European legislator adopted the Capital Requirements Directive (known as CRD III) as a further partial response to the crisis as well as the directives under which the European Supervisory Authorities (ESAs) with the European Banking Authority (EBA) and respective authorities for insurance (EIOPA) as well as securities and markets (ESMA) and the European Systemic Risk Board (ESRB) were established. Together with the competent supervisory authorities, the ESRB, the ESAs and their Joint Committee form the ESFS.

In June 2013, the Capital Requirements Regulation (CRR) and CRD IV were adopted, marking the pan-European implementation of the new Basel framework (Basel III), which had been fundamentally overhauled in response to the crisis. The adoption of prudential rules in a directly applicable EU regulation – the CRR – allowed for greater uniformity in the legislative framework, in line with the principle of maximum harmonization. In April 2014, further recommendations from the de Larosière Report were put into practice with the adoption of the Deposit Guarantee Schemes Directive (DGSD). This directive requires EU countries to introduce an ex ante deposit guarantee fund financed by the banking sector. In May 2014, the Banking Restructuring and Resolution Directive (BRRD) was adopted. The BRRD equipped supervisory authorities with new tools for preventing crises by taking early intervention measures. Furthermore, the BRRD grants the resolution authority the power to resolve failed credit institutions in a way that has the least impact on the system as possible.

There have long been discussions about whether having an integrated financial market raises the need for a competent cross-border supervisor. Evidently, the European sovereign debt crisis was the last nudge needed to set up the banking union within the euro area. In March 2013, the Single Supervisory Mechanism (SSM) was established with the European Central Bank (ECB) becoming responsible for the direct supervision of large credit institutions. In March 2014, the creation of the Single Resolution Mechanism (SRM) was decided on with the Single Resolution Board (SRB) located in Brussels as its central body. Similarly to the SSM, the SRM is a system of collaboration between the SRB and the national resolution authorities, supported by a single resolution fund. In November 2015, the Commission presented a proposal for completing the banking union, including a legislative proposal for establishing a single deposit guarantee scheme (European Deposit Insurance Scheme – EDIS). EDIS continues to be under discussion, however, as the Member States have not been able to agree on a compromise so far. Together, SSM, SRM and EDIS constitute the three pillars of banking union.

To conclude, a broad range of measures have been taken to strengthen the crisis resilience of individual financial institutions and the financial sector as a whole, and to establish European supervisory and regulatory mechanisms with a view to creating and eventually completing the – as yet incomplete – European banking union.

**Kaden, M., M. Boss und M. Schwaiger.2020.** Das europäische Regelwerk für Bankenaufsicht und sein institutioneller Rahmen seit dem EU-Beitritt Österreichs. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 135–154.

## Competition policymaking in Austria: looking back and beyond after 25 years of EU membership

Michael Böheim

Competition policymaking to ensure the viability of the common market is among the priorities for policymaking by the European Union. In Austria, corporate competition remained a largely unregulated area in the post-WWII period, while in Germany academics and practitioners established a competition tradition and culture early on. Pro-competitive policymaking did not really take off in Austria until we joined the EU. The adoption of the *acquis communautaire* on competition law and the supremacy of Union law created sufficient external pressures for Austria to align, with some delay, the relevant material rules of domestic law with Union law and to redesign the institutional governance of competition. These changes curbed the influence of the social partners (labor, employers and the government), limiting their say in competition cases and their powers of initiative. The existing Cartel Court was retained as a decision-making body alongside a newly established Federal Competition Authority, which was given extensive investigative and enforcement powers (from 2002). The Federal Competition Authority has since come to play a pivotal institutional role, unlike the Competition Commission (also established in 2002), which has remained rather insignificant in the absence of the political will to seek independent advice for competition policymaking.

Experience with the competition policy reforms of the past 25 years in Austria has shown that implementing competition policy visions requires political staying power. Competition policy at the European level has been the main driver for the positive development in Austria. Although much has improved in Austria due to exogenous pressure, there is still a need for improvement in individual areas. Despite numerous measures to improve competition law ("know-how") in detail, Austria as a whole still lacks a corresponding competition policy as a superstructure ("know-why"). After all, competition policy goes beyond processing cartel law cases. A modern competition policy requires an overall strategy ("grand design") that is coordinated with other policy areas (regulatory, industrial, infrastructure, energy and environmental policy, etc.). Although urgently needed, such an overall strategy for competition policy is not discernible in Austria even 25 years after accession to the EU. Those bearing political responsibility do not appear to take a particular interest, and the competition authorities with operational activities lack the time for strategizing in addition to handling individual cases. However, a competition policy that acts only on a case-by-case basis runs the risk of overlooking essential macroeconomic interrelationships, which is why a "grand design" for Austrian competition policy (competition policy in a small open economy) would have to be developed with emphasis.

An upgraded Competition Commission could play a major role in this respect. So far, the Federal Competition Authority and the Ministry of Digital and Economic Affairs have largely refrained from providing well-founded advice to and seeking a lively exchange of views (beyond the minimum required by law) with the expert body assigned to it. Especially an administrative authority with a monocratic structure would be well advised to proactively seek this exchange of views on content instead of being reluctant to accept it. In this climate of intellectual compartmentalization, the Federal Cartel Prosecutor appears indispensable as a corrective to the Federal Competition Authority. The government program for the legislative period 2020–2024 provides (once again) for a merger of the two institutions to "leverage synergies." This article makes a case for retaining two separate institutions but also calls for a more proactive and a more

public role of the Federal Cartel Prosecutor, subject to clear guidance that would have to be developed.

Giving the Competition Commission a more prominent role beyond the day-to-day business of competition law operations would help to sharpen the focus of competition policy. Playing a more prominent role should involve drawing up an independent competition report at least every two years. To this end, the Competition Commission would have its own (small) budget and full budget authority. While it would of course be helpful for the Commission to have its own staff (independent from the Federal Competition Authority), this does not appear to be an absolute necessity. The members of the Competition Commission, which should be only truly independent experts from science, research and professional practice, could write the expert opinions themselves subject to adequate compensation, which at the moment is not the case.

However, as long as the Competition Commission's members receive just attendance fees, the basic work on competition policy in the form of expert reports on general competition policy issues comparable to the main and special reports of the German Monopolies Commission will remain largely dead law – and the Competition Commission as an expert body on competition policy will remain virtually meaningless. A mere 10% of the budget of Federal Competition Authority would enable the Competition Commission to do its job as envisaged by the law. Partially earmarking fines, as was recently done for the benefit of the Federal Competition Authority, would be an effective way forward for upgrading the Competition Commission after the role-model of the German Monopolies Commission as originally intended. Unfortunately, however, the political will and interest in independent basic work and advice on competition policy even after 25 years after Austria joined the EU still does not seem to be sufficiently present. In this respect it seems that although a good part of the way has been covered, it is clear that Austrian competition policy still has a long way to go to Europe. May it not take another 25 years!

**Böheim, M. 2020.** Wettbewerbspolitik in Österreich im europäischen Kontext – Rückblick und Ausblick 25 Jahre nach dem EU-Beitritt. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 155–168.

## Long-term drivers of inflation in Austria and the effects of EU accession

Teresa Messner,  
Fabio Rumler

The purpose of this study is to identify if and how the inflation process in Austria has changed in recent decades in line with the changing economic framework, including the monetary regime changes in the U.S.A. and in Europe and external commodity price shocks (especially oil price shocks) but also effects of integration and globalization as well as changes in the domestic economy and lastly changes in productivity. In particular, we study the effects of Austria's accession to the European Union (EU), its participation in Europe's Economic and Monetary Union (EMU), the globalization of the economy and the financial and economic crisis of 2008–2009 on inflation.

To do so, we tested numerous specifications of an extended Phillips curve model. The Phillips curve is the most common macroeconomic model used to explain the interaction between inflation and real economic activity in the short to medium term. Broadly following the literature, we specified our model using quarterly data for the Austrian consumer price index as the variable we seek to explain and the Austrian output gap measuring how far the economy is from its “potential” level, adjusted for short-term fluctuations associated with the business cycle, as the inflation-driving variable. In addition, we use several control variables, such as the change in oil prices, change in productivity, a measure of trade openness and the monetary policy interest rate over the time period from Q1 1980 to Q3 2019.

In order to assess the influence of the above-mentioned factors on Austrian inflation, we first tested the model for structural breaks. These tests revealed three significant structural breaks that indeed coincide with the changes in the economic framework described above: one break in the mid-1980s, a period generally associated with the beginning of the Great Moderation; another break in 1995, the year of Austria's EU accession; and a third break in 2000, which coincided with EMU implementation. Thus, the relationship between inflation and its determinants in Austria obviously changed a couple of times over the last 40 years. To learn more about these changes, we estimated our Phillips curve specification for the subperiods that result from the structural break test. Furthermore, we also estimated a time-varying coefficient model as the validity of the results may have been weakened by the short samples of the subperiod estimations.

Our estimations yield a stable Phillips curve for Austria for most of the past 40 years. In other words, we find inflation to have been positively correlated with economic activity, subject to a temporary weakening of this relationship during the 1990s. During that period, the impact of external factors on domestic inflation such as Austria's EU accession, EMU implementation and globalization is likely to have increased. After the turn of the century and, in particular, after the financial and economic crisis of 2008–2009 the relationship between inflation and economic activity strengthened again. Similarly, the effect of the oil price on Austrian inflation has also increased starting with the strong oil price swings observed after 2005. Interestingly, monetary policy did not have a measurable impact on inflation developments in Austria before the time of EMU participation, which implies that the transmission of the Eurosystem's stability-oriented monetary policy has been working effectively in Austria.

Austria's economic framework is going to change further in the future: The integration processes through the expansion of the EU (especially EU integration of the Balkan countries, which are important for Austrian foreign trade) as well as the future development of digitization (increase

in e-commerce), globalization, and the effects of climate change are likely to affect the process of inflation in Austria in the years ahead. Assessing these effects and of course also the impact of the coronavirus pandemic will pose challenges for Austrian inflation research in the future.

**Messner, T. und F. Rumler. 2020.** Langfristige Determinanten der österreichischen Inflation – die Rolle des EU-Beitritts. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 169–179.

# The development of the EU budget and its impact on Austria

Walpurga Köhler-Töglhofer,

Lukas Reiss

Since its accession to the European Union in 1995, Austria has had financial linkages to the EU budget and to the EU's extended financial architecture. The latter encompasses units outside the EU budget with financial linkages to either the EU budget and/or the EU Member States, which also contribute to achieving the EU's goals. This includes the European Investment Bank, credit facilities with guarantees from the EU budget or from the Member States, and the institutions primarily serving the euro area members (e.g. the ECB).

The article focuses on the EU budget in a narrow sense, which typically makes up about 1% of the EU's gross national income (GNI). The EU budget is mainly funded from national contributions, which currently mainly depend on the respective GNI levels. Furthermore, some centrally regulated levies (above all import duties) are collected in a decentralized manner on behalf of the EU. The importance of these levies has decreased substantially over the last decades due to trade liberalization and the growing financing needs of the EU budget. In terms of expenditure from the EU budget, transfers to the Member States account for the largest shares, with most of the transfers coming from the EU's agricultural funds and its structural and cohesion funds. The relative role of agricultural transfers has decreased substantially over time, while other areas like R&D funding have gained in importance.

As a high-income Member State, Austria has been a net payer since it joined the EU in 1995. Chart 1 shows the average net positions of EU Member States from 2014 to 2018 (black lines) as well as the key determinants of net payments (bars). Like the other top net contributors, Austria enjoys a rebate on its national contribution (so the pink bar in chart 1 is lower than for other Member States), though other Member States get much larger rebates (especially the Netherlands and the U.K.). Due to these rebates, no Member State recorded a net contribution above 0.5% of GNI over 2014 to 2018 (chart 1).<sup>1</sup>

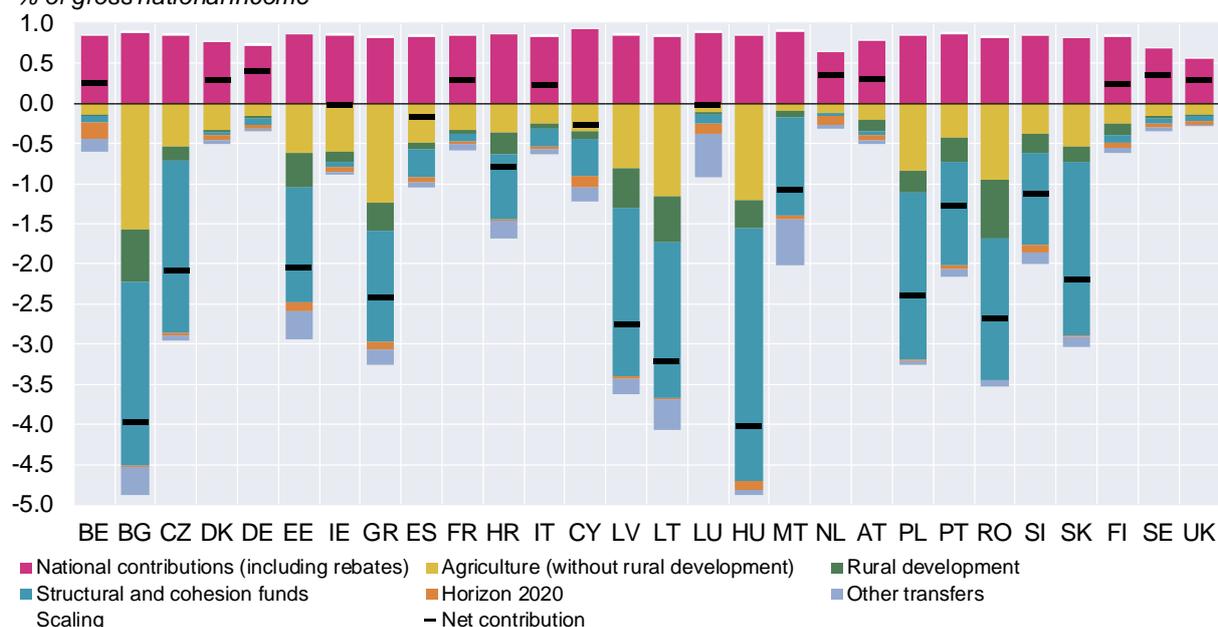
Similar to most other high-income Member States, most of the transfers out of the EU budget to Austria are agricultural transfers (yellow and green bars in chart 1). Compared to most other Member States, Austria receives relatively more transfers for rural development (second pillar of agricultural policies; green bar in chart 1) compared to direct payments to farmers (first pillar; yellow bar in chart 1). Transfers from the structural and cohesion funds (blue bars) mainly go to middle- and lower-income Member States. While there is no national co-financing of direct payments to farmers, countries have to co-finance EU transfers for rural development and from structural and cohesion funds, where rates tend to increase with national or regional GDP per capita levels. Due to the targeted nature of the structural and cohesion fund transfers, net receipts from the EU budget exceeded 2% of GNI for 10 Member States (Greece and most members from the CESEE region) from 2014 to 2018.

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<sup>1</sup> Chart 1 follows the official representation of net contributions by the European Commission, where EU budget revenue from own taxes and expenditure on administration is taken out. To ensure that the Member States' net positions add up to zero, national contributions have to be scaled accordingly (small white bars in chart 1).

## Net contributions to the EU budget 2014-2018

% of gross national income



Source: European Commission, OeNB.

However, a too narrow focus on rebates on contributions and on the size of EU transfers leaves out the benefits of the single market on highly competitive small open economies like Austria. This has to be taken in mind when looking at the ongoing negotiations over the forthcoming EU financial framework for 2021 to 2027, where Austria's net contributions may increase significantly (e.g. with the net payer U.K. leaving the EU) and where further financial burdens for Austria via the extended architecture are possible (e.g. via schemes directed at providing relief to Member States most affected by the ongoing economic crisis due to COVID-19).

**Köhler-Töglhofer, W. und L. Reiss. 2020.** Die Entwicklung des EU-Haushalts und die Auswirkungen auf Österreich. In: Monetary Policy & the Economy Q1–2/2020. OeNB. 180–194.

## EU economic policy recommendations and Austria's implementation score

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Economic policy coordination dates back to the beginnings of the European Economic Community (EEC), when the Community installed the “Monetary Committee with advisory status” as a coordination body as far back as the late 1950s.<sup>1</sup>

With the implementation of economic and monetary union in the 1990s, economic policy coordination became a necessity and a challenge. The increasing economic integration in the EU calls not only for common rules, but especially for economic policy coordination in order to avoid negative spillover effects and to increase the resilience of the EU in the event of negative shocks. To this end, broad guidelines for the economic policies of the Member States and of the European Union have been defined to set economic policy priorities since 1993. These guidelines and priorities relate to macroeconomic stability, sustainable public finances, research and development, innovation, structural reforms to improve business-friendly framework conditions, strengthening the internal market and competition, the creation of high-quality jobs, education and training, sustainable growth and environmental protection. To this day, the broad economic policy guidelines (later called integrated guidelines) continue to play the key role in the overall process of economic policy coordination. In practical terms, however, much of the coordination now occurs within the European Semester regime introduced in 2011.

The real challenge with regard to the broad economic policy guidelines is deriving country-specific recommendations as priorities for each EU Member State in a consistent and meaningful manner. Over time, distilling country-specific recommendations from the broad guidelines has been a constant negotiation between offering precision through very detailed policy measures and offering guidance through general reform goals. The resulting discontinuity in the reform recommendations, which is particularly evident in the changing level of detail provided each year, harms coherence and ultimately undermines the achievement of objectives. On top of that, recommendations may interfere with the sovereignty of the EU Member States when they provide very concrete suggestions about the political measures to be taken. Furthermore, the country-specific recommendations are not legally binding; it is solely up to the EU Member States to decide if and how to implement the recommendations.

Since 2000, implementation of the country-specific recommendations has been assessed by the European Commission. Following the introduction of the European Semester, this assessment has been based on a 5-point qualitative scale covering both the country-specific recommendations of the previous year and the overall performance since 2011. So far, at least some progress has been made with regard to 69% of all recommendations issued since 2011 according to the multi-year assessments. However, the implementation report published by the European Commission in 2019 reveals that eight years after the first European Semester, only 9% of the country-specific

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<sup>1</sup> cf. Article 105 (2) EEC Treaty.

recommendations had been fully addressed, while 5% were yet to be addressed at all. Furthermore, Efstathiou et. al. (2019) show that the EU Member States have mainly implemented recommendations regarding the financial sector, while action taken with regard to tax policy recommendations has been very limited. They also find that the likelihood of implementation is influenced above all by market pressure: recommendations are more likely to be followed when fiscal and current account deficits have risen to high levels, or when financial markets exert great pressure (potential loss of access to financial markets). Possible sanctions as part of the Macroeconomic Imbalance Procedure (MIP) seem to have no effect.

Austria has been implementing the country-specific recommendations to an even lesser extent than the EU Member States on average. Since 2011, almost 50% of the country-specific recommendations for Austria have not or not fully been implemented; only 5% have been fully implemented. Implementation issues relate to the area of fiscal federalism, the tax burden on labor, the long-term sustainability of the pension system, labor market issues and the increasing competition in the service sector. Like its EU peers, Austria has largely implemented above all recommendations regarding the financial sector. In the future, the implementation score may be influenced by new developments in the context of the multiannual financial framework (e.g. conditionalities of the Resilience and Recovery Facility) and the Green Deal.

**Auböck, M. und D. Prammer. 2020.** Wirtschaftspolitische Empfehlungen in der EU und deren Umsetzungsbilanz in Österreich. In: Monetary Policy & the Economy Q1-2/2020. OeNB. 195–209.