

## REASONS FOR AUSTRIA'S CURRENT ACCOUNT DEFICIT

*Since the early 1990s, Austria's balance on current account has deteriorated, mainly as a result of the plunge in the surplus of travel services. The relatively high deficit in the trade balance showed only minor changes.*

In the course of the 1990s, Austria's balance on current account has steadily deteriorated. Beginning the decade in equilibrium, the current account posted a deficit of 1.8 percent of GDP in 1996. A deficit of this magnitude was last recorded in the early 1980s after the second oil price shock, when the current account problems resulted from hefty deficits in the energy and merchandise trade balance. Now the deficit is related to problems in the tourism sector: the surplus in the balance of travel services dropped from ATS 70 billion in 1991 to ATS 23 billion in 1996.

In 1997, the growth in the current account deficit appears to have been arrested. The new strength is primarily due to weak domestic demand in the wake of the fiscal austerity program, the export boom, and the trend reversal in foreign exchange rates.

In the first eight months of 1997, the current account deficit was ATS 32 billion, ATS 2 billion more than in the previous year. The deficit in merchandise trade declined, but the export surplus for tourism continued to decrease.

Yet, in an international comparison, the situation remains bleak. Among the fifteen EU countries, only four post a current account deficit: Greece, Portugal, Austria, and Germany (with its problems stemming from reunification). Austria places third to last among all EU countries, ranking just ahead of Portugal and Greece (Figure 1)<sup>1</sup>.

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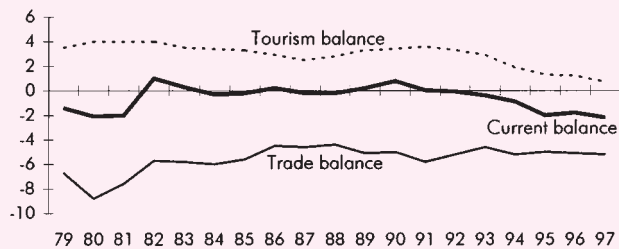
<sup>1</sup> In international comparisons, the balance on the current account is usually expressed as a percentage of GDP. It must be kept in mind that in a two-country comparison, given the same export/import ratio, the country with high foreign trade will record a higher deficit or surplus in percent of GDP than a country with small foreign trade. The following definitional relation exists between net exports as a percentage of GDP and the export/import ratio:

$$\frac{X-M}{GDP} = \frac{M}{GDP} \cdot \left( \frac{X}{M} - 1 \right),$$

$X$  . . . exports of goods and services,  $M$  . . . imports of goods and services.

Figure 1: Long-term development of the current balance and its most important components

As a percentage of GDP



Source: Austrian National Bank, WIFO. 1996: provisional data; 1997: projections.

Within a certain limit, a country may support a current account deficit as long as it attracts foreign capital (especially direct investment) and does not experience a loss in foreign exchange reserves. These conditions apply to Austria: since Austria's entry into the EU, foreign direct investment has surged, and foreign exchange reserves have increased.

Even though the deficit on the current account is offset by capital inflows, a high shortfall in the current account may point to a weak international competitive position; this is a problem that demands a solution.

In order to illustrate the importance of the current account balance of the competitive position of the economy, its components must be analyzed. In 1995 one half, in 1996 three quarters of the large deficit was accounted for by the balance on goods and services; the remainder is due to the transfer balance according to Balance of Payments Statistics. According to National Accounts Statistics, net exports on goods and services account for only one fourth of the deficit on the current account, while three fourths are due to the transfer and factor income balance. The worsening of the current account balance is mainly due, however, to the balance on goods and services: while still positive in 1991 (ATS 16.7 billion), the balance was negative in 1996 with a deficit of ATS 13 billion.

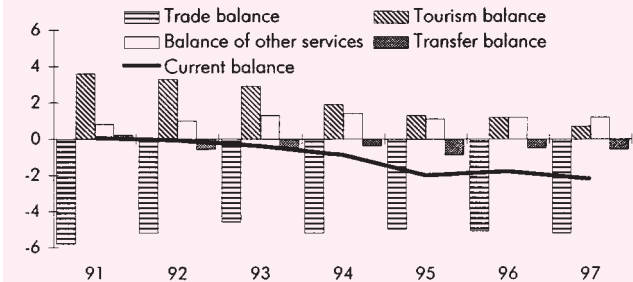
### TOURISM AS A KEY FACTOR IN THE DETERIORATION OF THE CURRENT ACCOUNT BALANCE

The balance of travel services was the most important component in the worsening of the current account balance in the 1990s. The paper by Smeral<sup>2</sup> shows that the drastic decline in the export surplus for tourism is primarily due to the decline in foreign demand for Austrian tourism

<sup>2</sup> Smeral, E., "The Decline in the Tourism Surplus", in this issue.

Figure 2: Components of the current balance

As a percentage of GDP



Source: Austrian National Bank, WIFO. 1996: provisional data; 1997: projections.

services. If the development of the tourism balance is measured against a "normal" path of tourism exports and imports, about three fourths of the decline in the tourism surplus can be attributed to exports and one fourth to imports.

The effects of structural problems were significantly larger than those of changes in foreign exchange rates. The rise in relative prices entailed by the appreciation of the schilling can explain only one fourth of the deterioration in the tourism balance. Three fourths of the change can be attributed to problems in the structure of touristic supply. These problems were serious in the summer but not in the winter season.

In the first half of the 1990s the current account balance worsened more or less in tandem with that of the tourism balance (Figure 3); in 1995, a new factor was added on the transfer balance – net payments to the EU.

The precipitous decline in the tourism surplus occurred between 1992 and 1995 when the schilling strongly appreciated (+8 percent); this at first pointed to the influence of changes in the effective exchange rate. But the persistent decrease in the tourism surplus in recent years, when the value of the schilling stabilized, suggests that structural problems in the tourism industry exert great influence.

### OUTFLOW OF PURCHASING POWER ONLY ONE FIFTH OF THE SURGE IN EXPENDITURES ABROAD

Expenditures by Austrians abroad comprise spending on travel services as well as cross-border purchases. These purchases account for a substantial part of foreign exchange spending by Austrians, but do not contribute much to the explanation of the plunge in the tourism balance.

According to surveys by Fessel + Gfk, the purchases by resident households abroad rose by about ATS 12 billion from 1991 to 1995, but declined by ATS 2 billion to 45 billion in 1997, as estimated by WIFO. Thus, Austrian

Table 1: Current account balances in an international comparison

	1997 As a percentage of GDP
Luxembourg	14.6
Netherlands	5.4
Belgium	5.0
Italy	3.7
Finland	3.7
Ireland	3.3
France	2.4
Sweden	1.9
Spain	1.0
Denmark	0.2
U.K.	0.0
Germany	- 0.6
Austria	- 1.6
Portugal	- 2.4
Greece	- 2.9
EU	1.3
USA	- 1.0
Japan	2.3

Source: European Commission, October 1997.

consumers spend about 3 percent of their income on cross-border purchases.

While cross-border purchases by Austrians in Germany barely changed, those in Italy and eastern Europe increased sharply in the 1990s. When the value of the Italian lira rose in 1996 cross-border purchases leveled off.

In the 1990s, purchases by resident households abroad did not grow as fast as expenditures on travel services abroad. In the period from 1991 to 1997, cross-border purchases contributed only about one fifth to the surge in foreign exchange spending (ATS +48 billion).

There are few data available on the volume of purchases in the domestic market by non-resident households in Austria; under the assumptions that the inflow of purchasing

Table 2: Net exports, transfer balance and net factor income

	1991	1992	1993	1994	1995	1996 <sup>1</sup>
	Billion ATS					
<i>According to National Accounts Statistics (NAS)</i>						
Net exports <sup>2</sup>	16.7	19.7	13.9	- 4.1	- 9.6	-13.0
Transfer balance <sup>3</sup>	- 2.8	-11.6	-12.7	- 8.3	-24.1	-29.2
Net factor income	-13.1	- 9.7	- 9.4	- 8.2	- 7.6	- 7.6
Balance on current account	0.8	- 1.6	- 8.2	-20.6	-41.3	-49.8
<i>According to Balance of Payments Statistics (BOP)</i>						
Balance on current account	0.8	- 1.6	- 8.2	-20.6	-47.0	-42.4
Current account differential between NAS and BOP calculation <sup>3</sup>	± 0.0	± 0.0	± 0.0	± 0.0	+ 5.7	- 7.4

Source: Austrian Central Statistical Office, Austrian National Bank. - <sup>1</sup> Provisional data. - <sup>2</sup> Exports of goods and services minus imports of goods and services. - <sup>3</sup> The difference is due to two factors:

- adjustment for import duties in the National Accounts Statistics totaling ATS 10½ billion in 1996,
- EU subsidies are recorded on an accrual basis in the National Accounts Statistics, on a cash basis in the Balance of Payments Statistics; the difference amounts to about ATS 7½ billion in 1996.

Table 3: The balance of travel services and the current account

	Tourism balance		Balance on current account	
	Billion ATS	Changes from previous year in billion ATS	Billion ATS	Changes from previous year in billion ATS
1991	70.9	+10.0	0.8	-12.8
1992	67.4	- 3.5	- 1.6	- 2.4
1993	61.4	- 6.0	- 8.2	- 6.6
1994	42.8	-18.6	-20.6	-12.4
1995	29.5	-13.3	-47.0	-26.4
1996	23.1	- 6.4	-42.4	+ 4.6
1997	16.8	- 6.3	-54.8	-12.4

Source: Austrian National Bank, WIFO. 1996: provisional data; 1997: projections.

power increased by some ATS 2 billion from 1991 to 1997, net cross-border purchases (ATS +8 billion) account for only one seventh of the deterioration in the tourism balance (ATS 54 billion).

## HIGH TRADE DEFICIT PERSISTS

An analysis of the development and structure of the trade balance for the 1990s is impeded by the lack of reliable statistics: according to those compiled by the Austrian National Bank, the deficit in merchandise payments was rather stable, while the foreign trade statistics, as compiled by the Central Statistical Office, record high yearly fluctuations and a downward trend in the deficit. The September estimates of the trade balance by WIFO deviate from the official statistics for the last few years.

Because of the problems in categorizing goods, services, and unclassified goods or services (NAL), it is useful to consider the sum of goods and services (excluding travel services and factor incomes, but including NAL): this sum, amounting to about -2 percent of GDP, remained unchanged from 1992 to 1994 and declined to -1.5 percent of GDP by 1996 (according to the Central Statistical Office; Figure 4). Even though such a deficit is small in a historical perspective, it cannot provide comfort to policymakers: it should be clear that the drastic deterioration in the tourism balance can be offset only by an improvement in the balance of goods and (non-travel) services.

Table 4: Balance of trade with goods and services

	Balance of merchandise payments <sup>1</sup>	Balance of merchandise trade <sup>2</sup>	Balance of goods and services <sup>3</sup>
	Billion ATS		
1991	-69.8	-112.9	-54.2
1992	-67.8	-106.4	-47.7
1993	-74.4	- 97.7	-47.5
1994	-78.9	-116.4	-46.9
1995	-72.7	-116.1	-39.1
1996 <sup>4</sup>	-76.6	-121.8	-36.1

<sup>1</sup> According to the Austrian National Bank. - <sup>2</sup> According to WIFO (September estimates). - <sup>3</sup> Excluding tourism balance, according to the Central Statistical Office. - <sup>4</sup> Provisional data.

An analysis of the performance of the Austrian export sector in the 1990s shows that Austria has gained market shares in the export markets in real terms but has suffered losses on the domestic market. As far as world trade is concerned, Austria, like all of Europe, lost market shares in real terms – a mirror image of the stellar performance of the economies of South-East Asia and of the USA.

### NET PAYMENTS TO THE EU WEIGH DOWN TRANSFER BALANCE

In 1996, the balance of services (excluding travel services) posted a surplus of ATS 30 billion. This surplus, which at present is considerably higher than the tourism surplus, was generated, however, entirely by traditional services (such as transportation); modern service industries yielded a deficit of about ATS 5 billion. Throughout the 1990s, the transfer balance was in deficit. Since 1995, the transfer balance has been weighed down by substantial net payments to the EU. These payments amounted to ATS 13½ billion in 1996 and (because of delayed payments from the EU for 1995) to ATS 3½ billion in 1996. In the long term, these payments to the EU should be more than offset by additional exports of goods and services to EU member countries.

In 1995 and 1996, the balance of factor income was also in deficit (ATS 7½ billion).

### THE IMPACT OF THE BUSINESS CYCLE ON THE CURRENT ACCOUNT

Fluctuations in economic activity may exert a strong influence on the current account. If demand grows faster in the domestic economy than in other economies, the deficit in the current account tends to rise.

The impact of domestic demand on the current account can best be illustrated by analyzing the export/import ratio, which can be broken up into two components<sup>3</sup>:

- the growth differential in total domestic demand between Austria and major trading partners (cyclical effects),

<sup>3</sup> The export/import ratio can be broken up into two components: the relation between export and import shares and the ratio between domestic demand in Austria and abroad:

$$\frac{X}{M} = \frac{X}{GLV_{EU}} / \frac{M}{GLV_A} / \frac{GLV_A}{GLV_{EU}}$$

$GLV_A$  . . . real total domestic demand in Austria,  $GLV_{EU}$  . . . real total domestic demand of major trading partners (weighted by export shares),  $X$  . . . exports,  $M$  . . . imports.

Table 5: Development of Austria's export market shares

	Austria's market shares in export markets (according to WIFO) in real terms	Market shares of the EU in world exports in real terms	Austria's market shares in world exports in nominal terms
	Percentage changes from previous year		Percentage shares
1992	-1.2	-1.2	1.22
1993	-0.9	-2.3	1.11
1994	+1.6	-0.3	1.10
1995	+2.1	-2.5	1.30
1996	-0.8	-0.2	1.26
1997	+0.9	-0.9	0.97

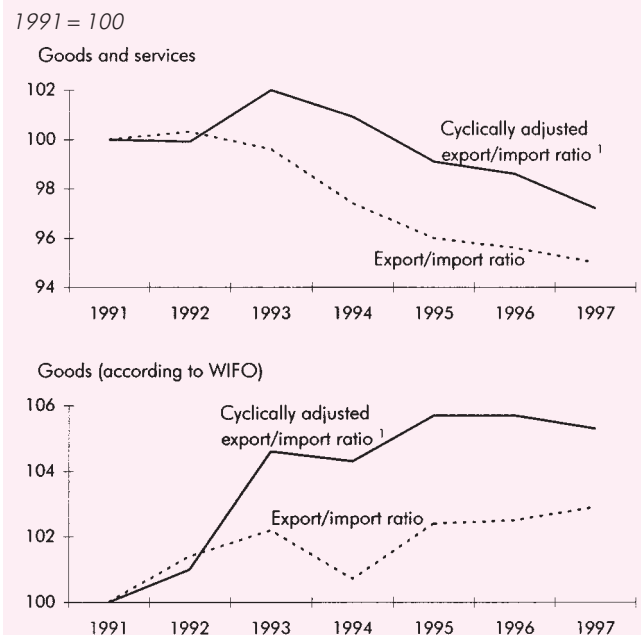
1997: Projections.

- the development of the “cyclically adjusted” export/import ratio, i.e., the ratio of export to import shares.

In the recession year 1993 and in 1994 (tax reform), the growth of total domestic demand in Austria markedly exceeded that in major trading partners (in Germany and Italy in particular). This contributed to the worsening of the current account balance: while the cyclically adjusted export/import ratio declined by 3 percent from 1991 to 1997, the unadjusted ratio dropped by 5 percent.

During the last few years the growth of total domestic demand in Austria lagged behind that in the major trading partners; nonetheless, the large excess incurred in 1993 and 1994 has not been reversed yet. In 1997, the growth rate of total domestic demand in Austria is estimated to be 0.8 percentage points below that in major trading partners. This, together with the realignment of foreign exchange rates, contributed to the stabilization of the current account balance.

Figure 3: Export/import ratio



Source: WIFO. 1997: projections. – <sup>1</sup> Adjusted for the growth differential of real total domestic demand between Austria and its 15 most important trading partners.

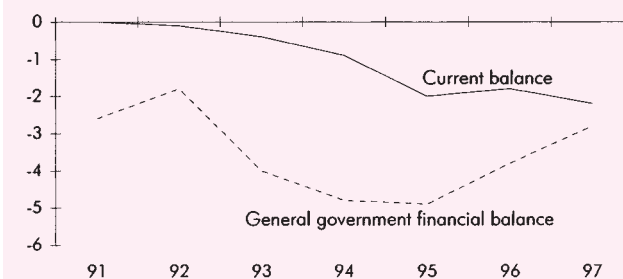
Table 6: Export/import ratio (goods and services) and relative growth performance

	Cyclically adjusted export/import ratio		Growth differential <sup>1</sup> : Austria vis-à-vis 15 trading partners	Export/import ratio	
	1991 = 100	Percentage changes from previous year		1991 = 100	Percentage changes from previous year
1991	100.0	-0.3	+0.8	100.0	-1.1
1992	99.9	-0.1	-0.4	100.3	+0.3
1993	102.0	+2.0	+2.8	99.6	-0.7
1994	100.9	-1.1	+1.2	97.4	-2.2
1995	99.1	-1.8	-0.3	96.0	-1.5
1996	98.6	-0.5	-0.1	95.6	-0.4
1997	97.2	-1.4	-0.8	95.0	-0.6

Source: OECD, Austrian Central Statistical Office, WIFO. 1997: projections. – <sup>1</sup> Based on real total domestic demand.

Figure 4: General government financial balance and the deficit in the current account

As a percentage of GDP



Source: Austrian National Bank, WIFO. 1997: projections.

### Reasons for Austria's Current Account Deficit – Summary

In the course of the 1990s, the balance on current account has increasingly become a problem of central importance to the Austrian economy. Beginning the decade with a balanced result, it reached a deficit of 1.8 percent of GDP (ATS 42.4 billion in preliminary figures) in 1996, a level last seen in the early 1980s after the second oil price shock.

This year, the growth of the current account deficit appears to have been arrested, in spite of expectations to the contrary. The new strength is due primarily to weak domestic demand and favorable exchange rate effects. In the first eight months of 1997, the current account deficit was ATS 32 billion, or ATS 2 billion more than in the previous year.

Yet the situation continues to be unpromising in an international comparison: in terms of current account, Austria places last but two among all EU countries, ranking just before Portugal and Greece.

Nevertheless, when we look at the average of 1995 and 1996, just half of the large deficit was contributed by the balance on goods and services, while the other half stemmed from the balance on transfers. The medium-term deterioration was, however, due mostly to net imports.

A key factor for the shift from surplus to deficit was tourist travel, which declined by ATS 48 billion between 1991 and 1996.

Of this decline, three quarters were the result of weak tourist travel exports, and the rest growing expenditures by Austrians abroad.

The price increase associated with the higher value of the schilling explains one quarter of the deterioration of the balance on tourist travel on the export side and some 40 percent at the import side. Most of the shift to the deficit therefore is due to "structural problems", which are particularly marked in summer tourism.

The increasing expenditure of Austrians abroad is chiefly a consequence of tourist travel. Although direct purchases by Austrians abroad similarly saw a pronounced rise, they still make up just one fifth of the increase in foreign currency expenditure that has occurred in the 1990s.

A proper analysis of the trade balance is impeded by the uncertainty of available data. Nevertheless it appears reasonable to assume that the trade balance could not effectively counteract the deterioration of the balance on tourist travel. The trade balance deficit remained high throughout the period. In the long term, the negative balance on tourist travel may be compensated only by sustained improvement in the goods and (non-tourist) services figures. It is remarkable that the balance of commercial services (excluding tourism) had already achieved a greater surplus in 1996 (ATS +30 billion) than the balance on tourist travel.

In terms of global exports, Austria – like all of Europe – was affected by a noticeable loss of real market share in the 1990s. Austria gained market shares in its export markets, but lost them in the domestic markets.

The balance on transfers was clearly negative throughout the 1990s. Since 1995, it has been affected by net payments to the EU: these were ATS 13 billion in 1995, but just ATS 3.4 billion in 1996 (partly due to delayed payments made by the EU for 1995).

According to the equations listed above, a drop in the growth rate of total domestic demand in Austria by 1 percentage point lowers the deficit in the current account by ATS 10½ billion, *ceteris paribus*.

The cyclically adjusted export/import ratio increased up to 1993, but has been declining steadily since then. This development is in agreement with the view that exchange rates are a major determinant of exports and imports, but that the current account reacts only with considerable delay to shifts in relative prices. In 1993, the current account was almost balanced, despite the major realignments in the fall of 1992, but then moved considerably into deficit in 1994 and 1995.

### THE INFLUENCE OF THE GOVERNMENT BUDGET ON THE CURRENT ACCOUNT

Some observers postulated a connection between the current account deficit and the rising government deficits ("twin deficits"). The data for the years 1993 and 1994 seem to confirm this hypothesis. The vigorous expansion of the budget deficit was accompanied by an above-average rise in total domestic demand and later on by a worsening of the current account balance. For other years, however, there is no evidence of a direct influence of the government budget on the current account balance: in 1996 and 1997 the shortfall in the current account remained high despite a substantial fall in the government deficit.