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CHANGE IN THE SERVICE TRADE REGIME WITH CEE COUNTRIES

When trade in services with the Central and Eastern European countries (CEECs) becomes more liberalised in the course of eastern enlargement, this will spell major changes for Austria's tertiary sector. In general, the outlook is quite favourable, considering how seriously backward the CEECs are in terms of their competitiveness, especially with regard to the more complex market services, and a substantial demand potential should build up. On the other hand, liberalisation will expose providers of labour-cost-intensive services on the Austrian side of the border to fiercer competition. Selective defensive measures and in particular an active structural policy will be necessary to improve their competitiveness and provide the groundwork to enable them to exploit the potential advantages offered by eastern enlargement.

Peter Mayerhofer is economist at WIFO. The author wishes to thank Norbert Geldner, Gerhard Palme and Gunther Tichy for his valuable proposals and suggestions. The data were processed and analysed with the support of Andrea Grabmayer, Andrea Hartmann and Maria Thalhammer. This contribution is based on the following study commissioned by the Austrian Conference on Statual Planning (OeROK) and carried out by the Austrian Institute of Economic Research (WIFO) and the Austrian Institute for Regional Studies and Spatial Planning (OeIR): Gerhard Palme, Christof Schremmer (Co-ordination), Regionale Auswirkungen der EU-Integration der MOEL, Vienna, 1998.

In assessing the overall effect that the envisaged enlargement of the European union by CEECs is expected to have on Austria, a major factor is its impact on the country's tertiary sector. After decades of a progressive shift towards the tertiary sector, services have come to dominate the economic structure, providing fully two thirds of all jobs in Austria. These are likely to experience a change in their regime as a consequence of the trade policy changes that will occur when five CEECs¹ are accepted in the European Union: previous steps towards liberalisation, taken in the course of association agreements with these countries, concerned almost exclusively the trade in commodities. Trade in services, on the other hand, is still burdened by high trade barriers, and these would be demolished in favour of a more liberal regime once the five CEECs join the EU. The impending steps will thus have their greatest impact in the tertiary sector.

Considering the implications, it is remarkable that virtually no detailed analyses have so far been made of the effects of ongoing European integration on the trade sector at national and international level. Apart from the fact that economic theory is as a rule less concerned with international trade in services, this shortcoming ap-

¹ Czech Republic, Estonia, Hungary, Poland, Slovenia.

Table 1: Austria's balance on current account with the EU applicants

1996

	Neighbouring transition countries ¹				Global			
	Inputs 1989 = 100	Outputs 1989 = 100	Balance Million ATS	Change to 1989 in billion ATS	Inputs 1989 = 100	Outputs 1989 = 100	Balance Million ATS	Change to 1989 in billion ATS
Commercial services	113.8	212.6	- 265	- 5.9	140.7	176.4	57,465	-14.7
Tourism	35.2	210.8	- 6,819	-11.9	104.0	150.6	22,689	-36.2
Transport	299.9		2,651	+ 1.8	171.6		30,247	+12.6
Other services	523.9	217.3	3,903	+ 4.2	268.6	228.9	4,529	+ 8.9
Adjustments	1,192.0	1,449.9	- 1,922	- 1.7	329.9	361.9	- 5,832	- 3.5
Merchandising	415.9		12,298	+ 9.3	177.3		11,239	+ 4.9
Factor incomes ²	3,728.6	50,000.0	- 1,239	- 1.2	1,223.2	359.4	1,322	+ 3.4
Services without investment income	134.0	170.0	8,872	+ 0.5	140.0	172.7	64,194	-10.0
Investment income	72.4	68.8	3,753	- 1.4	138.1	130.1	- 8,889	+ 3.4
From FDI	11,000.0	86.7	524	+ 0.5	138.6	112.3	- 8,881	- 0.3
Other investment income	63.7	68.3	3,229	- 1.9	138.0	132.4	- 8	+ 3.7
Total services	115.6	154.7	12,625	- 0.8	139.4	153.2	55,305	- 6.5
Merchandise	362.9	273.0	17,090	+17.1	142.6	138.5	-100,570	-15.2
Unclassified services	481.8	2,875.0	8,008	+ 6.0	230.7	658.6	12,825	-15.7
Transfers	693.0	192.2	- 566	- 0.1	266.1	301.1	- 10,930	- 9.3
Current account	245.6	244.7	37,157	+22.1	148.8	155.1	- 43,370	-46.6

Source: OeNB. – ¹ Czech Republic, Slovakia, Hungary, Poland, Slovenia. – ² Employee pay, patents, licences.

pears to be rooted in the various methodological and technical restrictions that obstruct efforts to analyse the sector (Reeh, 1996, Mayerhofer, 1998). In spite of such limitations, the present contribution attempts to furnish a preliminary overview of the potential effects that integration of five CEECs will have on Austria's tertiary sector. The dearth of available data makes it difficult to arrive at solid findings supported by empirical analyses. Improving the statistical underpinnings in the services sector would thus greatly help to reduce the imponderabilities of evaluating the consequences of eastern enlargement for Austria.

TRADE IN SERVICES WITH TRANSITION COUNTRIES ACHIEVES LARGE SURPLUSES

Trade in services with the neighbouring transition countries constitutes a major item of Austria's foreign trade. Without it, the current account deficit in 1996 would have been higher by 30 percent.

An indication of the situation of the Austrian tertiary sector after the opening of the east is supplied by statistical numbers on the payment flows between Austria and the transition countries adjoining it². According to these figures, in spite of existing barriers trade in services contributes considerably to Austria's positive net position vis-à-vis these

² The findings discussed here refer to Hungary, Slovenia, Poland, the Czech Republic and Slovakia. No detailed data are available on Estonia.

countries (Table 1). In 1996, Austria achieved a surplus of ATS 12.6 billion (0.52 percent of GDP), which was not much lower than the surplus for trade in goods (ATS 17.1 billion, 0.71 percent of GDP). Contrary to the overall trade in services, which has been rapidly shrinking in recent years primarily because of the structural crisis suffered by the tourism industry, the contraction for the transition countries in the 1990s was of a negligible scale (ATS -0.8 billion). Quite obviously, Austrian trade in services with these countries provided considerable relief to the country's balance on current account (Walterskirchen, 1998): Without the positive contribution furnished by tertiary trade with the five countries, the Austrian current account deficit would have been higher by 30 percent.

After the eastern opening, the surplus from the trade in services continued to derive mostly from transit trade (ATS +12.3 billion). This item includes chiefly barter deals, where Austrian companies purchase goods abroad and sell them to third countries without any intermediate processing. As part of counterdeals and compensation trading deals, these transactions were once the mainstay of traditional trade with the state trading countries. Such activities have lost much of their importance (at least in the trade with EU applicants) since trade relations have been normalised, and Austrian wholesalers apparently were able to direct their accumulated know-how into new business segments after 1989: by mediating between the eastern countries and, to a lesser extent, undertaking distribution functions for small and medium-scale private companies in the CEECs that had little experience of the global markets, they more than made up for the loss of traditional business lines. According to the available data, Austria's

net payment position in transit trade experienced a further surge after the eastern opening³. Substantial net inflows from trade with adjoining CEECs are obtained from investment income (ATS +3.8 billion), much of it still from "other investment income" (interest payments on loans, dividends). The inflows from income from FDI in the CEECs are rising at a similarly rapid pace, not least because Austrian investors made substantial commitments there after the eastern opening, but do not yet reach the level achieved by other components of the capital movement, because of the low original level and the fact that direct investment in the CEECs is still new and has therefore not yet reached its full gains potential.

Major net outflows are recorded with regard to "adjustments", an item that does not lend itself to easy interpretation (ATS -1.9 billion), and "factor incomes", which covers the outflow (of payments) for work from the CEECs, which, for all practical purposes, started only with the eastern opening and which far outweighs the negligible profits from patents and licences which are also posted under this heading. It appears that Austria is not entirely successful in its role of "technology supplier" to eastern Europe. The balance of trade with commercial services is also slightly negative. Outflows under this heading have doubled since the eastern opening, which resulted in a substantial deficit of almost ATS 6 billion. This finding is surprising insofar as the CEECs are still faced with a shortage in the supply of complex market services while demand has rocketed in the course of the transformation process, so that ample market opportunities should have arisen. Actually, the negative balance derives solely from "tourism" (ATS -6.8 billion), which deteriorated by almost ATS 12 billion in just seven years. A detailed sector analysis (Mayerhofer, 1998) shows that this deficit was not caused by tourism per se, but rather by other cross-border activities: purchasing power draining from cross-border shopping and, to a lesser extent, the use, by Austrians, of personal and health services in the CEECs and cross-border activities of CEEC providers in Austria.

All the other areas of commercial services provide confirmation that a considerable demand potential exists for complex market services. Although the high surplus from transport (ATS +2.7 billion) appears to be distorted by deficiencies in the processing of data⁴, other commercial ser-

vices have been showing a marked upward trend since the eastern opening: cross-border commission processing intensified (a plus of ATS 1.8 billion on balance), and revenues from leasing and rental transactions flourished (ATS +1.7 billion). Because of the widespread use of this type of financing for infrastructural investments, the CEECs have since become Austria's chief partner in this sector. Construction, assembly and repair works have similarly contributed a high surplus (ATS +1.1 billion) from the explosion of exports: in stark contrast to concerns voiced about competitive disadvantages vis-à-vis (cheap) providers in the CEECs, trade relations have so far been skewed in favour of Austria. The development is particularly dynamic (especially on the export side) with regard to "modern" services such as technological, scientific and economic consulting, advertising, and banking and financial services. Contrary to its position towards western industrialised countries, Austria is achieving surpluses in the CEECs, which are still small because of the low original level at the time of the eastern opening; this sector appears to offer a major potential for expansion.

Such expectations may be applied to the entire trade in services with the CEECs: unlike trade in goods, it continues to be governed by a rigid regime. Eastern enlargement should therefore make for a substantial expansion in tertiary trade. The assumption is underlined by the continuing strong bias towards goods shown by the structure of the trade with the applicants, as compared to overall foreign trade: in spite of the above-average importance of the transit trade, exports and imports in the trade of services with CEECs (23.5 and 17.6 percent, respectively) make up a distinctly lower proportion of the current account outflows and inflows than is the case when looking at all of Austria's trade partners (34.6 and 28.7 percent, respectively). The export share held by the CEECs in trade with commercial services and investments in particular is still noticeably lower than its general Austrian equivalent. A greater degree of harmonisation in foreign trade structures consequent to integration is thus likely to open up new potentials.

EASTERN ENLARGEMENT HAS GREAT IMPACT ON TRADE POLICY REGIME

Generally speaking, the analysis of Austria's foreign trade relations with the CEECs arrives at a positive conclusion: the Austrian tertiary sector was able to exploit the eastern opening by expanding its own markets; there was little effect from new competition. It would, however, be inappropriate to use the favourable development after 1989 in order to draw conclusions for perspectives after eastern enlargement. Membership of the CEECs in the European

³ It should, however, be noted that the scope of change shown in the balance of payments (a plus of ATS 9.3 billion since 1989) provides for some scepticism as to the reliability of the database. A more detailed analysis would be quite useful.

⁴ The balance of services provides a more or less complete picture only with regard to inflows; outflows, which are as a rule connected to shipments of goods, are often posted to the merchandise item, thereby reducing the trade balance.

Table 2: Current levels of regulations for services

	Example	Current trade barriers
Cross-border supply without change of location	Communications and information services	0
Use of a service abroad	Tourism	0
	Retail trade	++
Service rendered by a commercial branch operation	Branch offices, etc.	+++
Service rendered by the provider physically crossing the border	Construction work, trades and small businesses	+++

Source: WIFO. 0... no trade barriers, ++... extensive trade barriers, +++... very restrictive trade barriers.

Union means that an entirely new, more open integration regime will come into being. In terms of changes expected with regard to the legal framework⁵, we need to distinguish between four types of services which in actual practice are (or can be) governed by different regulations and which thus establish some kind of hierarchy as to the current degree of liberalisation awarded by Austria to the applicants (Table 2):

- *Cross-border supply without change of location:* A service is exported from one market participant's territory to another market participant's territory while the service provider does not itself cross the border. This is feasible only when consumer and producer need not meet in order for the service to be rendered. Such services (e.g., information and consulting services by fax or e-mail) can be provided across a distance, which rather limits (technological) opportunities for raising trade barriers. Already now, there are few restrictions to the international supply of such services, and few changes can be expected by eastern enlargement.
- *Use of a service abroad:* A service is used on the territory of another member state, for which purpose the consumer crosses the border (e.g., tourism or retail trade). Tourism lost all its trade barriers when compulsory visas were abolished for CEEC tourists in the early 1990s, so that no additional integration effects can be expected from eastern enlargement in this respect. Retail trade, on the other hand, continues to be subject to restrictive regulations regarding direct imports of goods from the CEECs⁶. These would be rescinded upon eastern enlargement. In addition, the abolition of border controls is expected to produce considerable time savings for border-crossing, which should fuel direct imports at a rate expected to exceed the scope reached at

Austria's western borders after it joined the EU, because of the large price differences between the two sides of the border (*Kratena – Wüger, 1997*): according to *ÖSTAT (1997)*, prices in the transition countries for goods categories that are typically involved in direct imports were just 30 to 50 percent of Austrian retail prices. This could create problems specifically for Austrian retailers in the border regions, which are already faced with the double challenge of a substantial drain of purchasing power to the adjoining CEECs⁷ and competition from large shopping centres in nearby urban areas. Extensive structural changes are the consequence⁸.

- *Service rendered by a commercial branch operation:* The service is rendered by the foreign provider's branch office in the consumer's country. At present, activities of this type by CEEC providers are mainly restricted by the regulations of the Austrian Commercial Code (qualification). Once they join the EU, national regulations (on education, training, etc.) will continue to apply to people from these countries with the proviso, however, of mutual recognition, a keystone of the law governing the single market. Under it, an individual is deemed to be qualified to exercise a trade when he/she has lawfully exercised it for a given period in an EU member state, has no criminal record and has not filed for bankruptcy. This principle will greatly facilitate establishment, although CEEC providers from the relevant tertiary sectors will generally be hampered by their inadequate competitiveness. While Austrian services companies (primarily banks, retailers, DIY markets, etc.) have already been making substantial direct investments in the CEECs as part of offensive strategies to expand their markets, branch operations run by CEEC providers in Austria should be the exception rather than rule even after eastern enlargement. Freedom of establishment is thus not likely to step up competitive pressure in Austria – rather it should provide an opportunity for Austrian companies to internationalise their business.
- *Service rendered by the provider crossing a border:* The provider crosses the border for a temporary stay abroad in order to render a service. Sectors involved in this type of service (mainly handicraft, building contractors, etc.)

⁷ According to WIFO estimates, the outflow has increased from ATS 2.5 billion in 1990 to about ATS 5 billion, much of it flowing to Hungary. The problem is particularly acute for some especially exposed product categories: in 1996, 23 percent of the cigarettes smoked in Austria (3.9 billion) were imported from abroad without payment of duties, half of them from its eastern neighbours (*Puwein – Wüger, 1998*).

⁸ Typical factors of structural changes are: a sharp decline in the number of retail stores, explosive growth of selling space, increasing geographical concentration of supply, and the retreat of retailers from areas of low population density.

⁵ For a more detailed discussion of this issue see *Mayerhofer (1998)*.

⁶ Overland travellers are currently permitted to import, duty-free, 25 cigarettes, 1 litre of wine, 1 litre of spirits or 2 litres of champagne, and goods to the tune of 75 ECU; specific regulations apply to meat products (1 kg), dairy products (1 kg), eggs (1 kg) and fruits (15 kg).

are of above-average importance for the economic structure of border regions. Experience accumulated after the eastern opening point to beneficial effects; but the production and employment gains after 1989 were achieved in a regime enjoying comprehensive protection under trade, establishment and labour laws and cannot therefore be transposed to the situation after eastern enlargement. Once the law of the single market (mutual recognition of qualifications, freedom of establishment) applies to the CEECs, it will greatly facilitate the provision of services across borders. Competitive pressure from cross-border services will come to bear primarily on providers of services with a high labour-cost component located within a day's distance of the border. Some relief will be provided by the EU Directive 96/71/EC concerning the posting of EU workers to another member state, which defuses the consequences of a change of regime for services rendered by employees. The Directive of December 1996, which must be incorporated in the law and administration of member states within three years and implemented by new members as part of the *acquis communautaire*, stipulates a "hard core" of protective rules (in terms of working hours, pay, safety at work, etc.) of the host country as a minimum standard enjoyed by workers posted across borders, aiming to prevent wage and social dumping in the cross-border trade of services (Müller, 1997). Considering, however, that Austrian workers are paid (occasionally very much) in excess of the collective wage level, problems in the sectors most affected by cross-border trade in services cannot be precluded⁹, particularly since the Directive does not concern services rendered by the self-employed.

Altogether, Austrian service providers will thus be confronted with a competitive regime changed considerably after eastern enlargement: competitive providers will doubtlessly discover great opportunities for expanding their markets, but some sectors will feel the full force of new competition.

OPPORTUNITIES FOR MARKET EXPANSION – NEW COMPETITIVE PRESSURES IN THE BORDER REGIONS

The CEECs appear to be even more backward in market services than in manufacturing (OECD, 1991, *Stare – Va-*

⁹ The Directive stipulates only that workers posted abroad be paid at the collective bargaining rate applicable in the host country. In practice, the wide gap between actual wages and collective bargain rates, which is a typical feature of business centres near the border, will thus provide an area of attack for price competition from the CEECs in spite of the Directive.

nyai, 1995, *Borish – Ding – Noel*, 1996, *ERECO*, 1998). Competitive services were not a priority under the economic doctrine of the Comecon, which stressed goods production; indeed, several complex financial and entrepreneurial services simply did not exist. In the early stages of transition, services made up just 30 to 35 percent of GDP in the CEECs, compared to 40 to 50 percent of GDP

New competition from the EU applicants is most likely to be felt by border-region service enterprises that have high labour costs. They employ about 11 percent of all dependent workers in Austria.

in market economies of comparable development level. Meanwhile, the economic base of CEECs has been shifting towards tertiary activities, and services are rapidly approaching western standards. So far, the catching-up process has been limited to traditional services, mostly of the consumer type. More complex producer services, which provide a critical catalyst function in the changeover to the market economy, still show serious quantitative and (even more) qualitative deficits. Service providers from the five applicants have so far been hardly able to accumulate company-specific competitive advantages, and they are still miles away from western European standards, especially in terms of range and quality of their services. For this reason, their home markets are already dominated by companies from western Europe.

Low competitiveness of higher-value services and growing demand fuelled by the catching-up process in the CEECs open up excellent prospects for service providers from the west to extend their markets. At the same time, competing importers from the CEECs will find it hard to achieve any competitive edge in terms of better product quality or greater product diversity in the medium run. In the short to medium run, they will be restricted to conquering submarkets, succeeding solely by competition on prices where they enjoy factor cost advantages primarily from their lower wage costs. As a result, the potential threat for Austria is limited to the labour-cost-intensive segments of the spectrum.

As a rule, this will affect Austrian enterprises which combine low wages (and thus low human-capital orientation) with a high ratio of personnel costs to total costs (i.e., a high wage tangent). By using disaggregated sectoral and regional data on incomes and wage tangents in Austria, it is thus possible to outline services sectors which are potentially affected by factor costs advantages enjoyed by the CEECs: sectors employing 721,000 workers in total (35.8 percent of all services sector workers) have an aver-

age wage rate and cost structure that makes them vulnerable to low-wage competitors. “Potentially affected”, however, by no means should be interpreted to mean that these sectors have no trump to play when the market is opened to new competitors. Experience from manufacturing, where trade is to a great extent liberalised, shows that even providers of labour-cost-intensive activities were able to exploit the opening and achieve a significant improvement of their profits, provided that they strengthened their competitiveness by quality and niche strategies and inter-regional division of labour (*Mayerhofer et al.*, 1998). Nevertheless, liberalisation will have an above-average impact on labour-cost-sensitive sectors insofar as their success will be increasingly determined by efforts to upgrade to higher-quality services and to make use of co-operative ventures.

Regardless of geographical considerations, however, new competitors even in labour-cost-sensitive sectors will emerge only for those services that can be provided across a greater distance. In such cases it is conceivable that locations will migrate, driven by factor costs: after eastern enlargement, the prospect of having an edge on production labour costs may induce a company to shift its location to the new member states without giving up its domestic market. Yet services are frequently of the “embodied” type, which makes it difficult or impossible to render them across greater distances (*Bhagwati*, 1984). Security or maintenance services and the like are tied to a given location and therefore territorially immobile. Other services are tied to a location by their material prerequisites: technical and consulting services are rendered “on site” of the customer’s premises, which means that the manufacturing sector’s location contributes to determining the complementary service provider’s location. And finally many services (especially of the consumer, social and public type) require the personal interaction of provider and recipient. Because of embodiment, the choice of location is greatly limited by the location of potential customers.

Embodiment hardly ever occurs in its ideal form, so that an attempt to categorise services by this criterion is always open to criticism. Yet if we distinguish – based on a categorisation for Germany (*Klodt*, 1995) – between “embodied” and “disembodied” activities of the Austrian tertiary sector, we find that segments employing just one quarter of the services workers have much freedom in their territorial provision of services. The remaining segments, employing more than three quarters of all services workers, are tied to their location because of the characteristics of the services offered by them. A vital stylised fact is provided by a comparison of the categories “labour-cost-sensitive/not labour-cost-sensitive” and “embodied/disembodied”: services with high labour-costs sensitivity (which

are thus potentially affected by cheap-labour competitors) are without exception (at least at the aggregation level analysed here) “embodied” and thus limited in their locational mobility. “Disembodied” services, i.e., those which enjoy considerable freedom in choosing their location, on the other hand are not of the labour-cost-intensive type: they offer complex services that are high on human capital, and they cumulate competitive advantages through their quality and networking capacity – dimensions which are not at the disposal of providers from the CEECs even in the long run because of their competitive weaknesses.

The potential threat from labour-cost advantages enjoyed by CEEC competitors will therefore be mostly limited to the border regions. It is only here that embodied, labour-cost-sensitive tertiary sectors must expect stepped-up competition from shopping trips across the border and services rendered by CEEC providers. The zone is defined by the distance across which this type of cross-border trade in services still makes economic sense. Assuming this to be a day-commuter’s distance¹⁰, sectors employing altogether 338,700 workers in all of Austria appear to be potentially affected by low-wage competitors. They make up some 17 percent of all services workers or 11 percent of all dependently employed workers in Austria (Table 3). Regionally, the impact varies considerably. All of Burgenland (47.5 percent of all services workers) and Carinthia (40.0 percent) are within the critical distance to the border. In Lower Austria (27.4 percent), Styria (25.2 percent), Upper Austria (15.6 percent) and Vienna (11.9 percent), on the other hand, the potential vulnerability should be markedly lower. The westernmost Länder of Salzburg, Tyrol and Vorarlberg, thanks to their distance to the eastern borders, should be hardly affected at all by cross-border services and shopping. Competition from the CEECs should be limited here to the occasional opening of branch offices that profits from the freedom of establishment.

PRIORITY FOR OFFENSIVE MEASURES TO DEVELOP MARKETS

From the above deliberations it may be assumed that the liberalised regime to be expected for trade in services in the course of eastern enlargement will make for far-reaching changes in the Austrian tertiary sector. The general outlook is not unfavourable even though current net gains for the services trade cannot be directly extrapolated to the CEEC applicants. At the same time, crucial differences were found in terms of competitiveness: so far service pro-

¹⁰ Here defined as the distance that can be spanned by a passenger car (a 90 minutes’ drive from centres in the border regions of the eastern neighbours).

Table 3: Embodied labour-cost-intensive services in the border regions

Dependently employed as per ÖNACE two-digit categories, 1997

	Vienna	Lower Austria	Burgenland	Styria	Carinthia	Upper Austria	Austria
50 Trade, maintenance and repair of cars	–	9,637	2,597	7,698	4,591	5,192	29,716
52 Retail trade (excluding cars)	–	29,085	4,165	20,977	13,117	15,214	82,559
55 Hotels and catering businesses	30,070	12,745	3,538	9,617	10,808	5,375	72,152
60 Land travel, pipeline transports	–	13,358	2,431	8,652	7,613	7,999	40,053
80 Education and training	13,700	–	4,097	14,173	9,645	–	41,615
85 Health care, veterinary care and social services	25,365	16,177	4,779	–	–	8,898	55,219
90 Waste water and garbage disposal	–	854	–	–	–	–	854
93 Other services	–	4,134	1,317	3,161	2,389	2,913	13,914
95 Private households	783	505	134	513	332	416	2,683
Total services	589,700	315,458	48,567	256,738	121,172	295,417	2,013,549
Vulnerable sectors in the border regions	69,918	86,495	23,058	64,790	48,495	46,006	338,763
Percentage shares in total services	11.9	27.4	47.5	25.2	40.0	15.6	16.8

Source: Federation of Austrian Social Security Institutions, own calculations. „Embodied“ services: services which are difficult or impossible to render across great distances because of their characteristics (cf. Klodt, 1995). „Border regions“: accessible by car (a 90 minutes' drive from centres in the border regions of the eastern neighbours).

viders from the CEECs have been mostly unable to catch up with western European quality standards, and they are frequently hampered by a shortage of management know-how and inefficient financing systems. Austrian entrepreneurs (among others), on the other hand, have already been able to expand briskly into the home markets of their competitors. Progress in opening the services sector promises a substantial demand potential, and Austrian providers should be able to make full use of it thanks to their proximity to the markets.

Greater liberalisation will obviously also intensify competition, especially with regard to labour-cost-intensive services. Its impact will be greatest in the border regions, and it will thus be appropriate to pursue a dual strategy to avoid major distortions¹¹:

- Selective defensive measures should be taken to prevent viable businesses from overstraining their capacity to adapt to the necessary and unavoidable structural change.
- Active structural policy measures will have to be taken to enhance the competitive strength of Austrian service providers and enable them to make full use of the potential advantages of eastern enlargement.

Defensive measures (for protection), such as transitional provisions or safeguard clauses, can be justified only when it is found that acceptance of the *acquis communautaire* by the new member states does not suffice to solve the problem. This is most likely to be the case with regard to cross-border shopping and cross-border provision of services by self-employed individuals. The adaptive strategy should, however, focus on offensive measures, involving primarily activities that foster networking in the newly

emerging regions and that help Austrian entrepreneurs penetrate these new markets. In view of the indubitably impressive opportunities opened up by the EU's eastern enlargement, it would make little sense to base concrete preparatory strategies solely on diffuse ideas as to potential threats: the benefits to be reaped by the services trade from eastern enlargement will not simply be brought about by geographical proximity but may be enjoyed only when appropriate economic and infrastructural policies help to stabilise actual business relations with customers, suppliers and partners across the borders.

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¹¹ For a more detailed discussion of a practical strategy to prepare for liberalisation see Mayerhofer (1998).

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Change in the Service Trade Regime with CEE Countries – Summary

The further opening up of markets will create a potentially high demand also in the services sector, and domestic providers should be able to exploit it due to their closeness to these markets. However, the boost in liberalisation tendencies will result in a keener competitive environment for labour cost intensive service activities, with border areas being affected more.

Already now the services trade with the neighbouring reform states contributes to alleviating Austria's current account problems despite still existing trade barriers: at ATS +12.6 billion (0.52 percent of GDP), the balance of service transactions with these countries is decidedly positive; without the contribution made by tertiary trade with the closest transition countries, Austria's current account deficit would have been by around 30 percent higher.

EU enlargement will greatly change the trade policy regime of Austria vis-à-vis these countries in key areas of the service portfolio: especially with regard to cross-border shopping, services rendered through business establishments in the host country and cross-border inroads made by foreign providers on domestic markets, eastern enlargement will signify a substantial trade policy opening. Whereas domestic providers should find new opportunities under the freedom of establishment due to the low competitiveness of CEE countries in the respective tertiary sectors, cross-border shopping and cross-border service provision are expected to create greater import competition.

In general, CEE countries are focusing on traditional consumption-close services in their attempts to catch up on western countries. With more complex producer services, CEEC providers have so far been hardly able to accumulate company-specific competitive advantages.

Especially in terms of product diversity and quality they are still far from western European standards. Concerning further expansionist drives of domestic providers, this poor competitive ability in higher-quality services in conjunction with growing demands generated by the catch-up process will open up favourable perspectives for market enlargement.

In terms of possible import competition, the present scenario implies that in the near future CEEC providers will hardly be in a position to derive competitive advantages from higher product quality or greater diversity in the range of services offered. Their expansion will be concentrated on partial markets in conjunction with pure price competition where they can exploit existing factor cost advantages. According to WIFO estimates the wage levels and/or cost structures of domestic service industries with approximately one third of all service employees are such that they may become vulnerable to low-wage competition. If we also take into account that any cross-border services (shopping tourism, cross-border inroads on Austrian service markets) are economically meaningful only across limited distances, the percentage of potentially affected service workers will be down to around 17 percent of all service workers (11 percent of dependent workers in Austria).

A dual strategy seems to be appropriate in preparation for EU enlargement. Selective defensive policies ought to avoid any overstraining of the companies' capability to adapt to the currently necessary structural changes, while active structural policies have to be stepped up with the aim of enhancing the competitive strength of domestic service providers and thus enabling them to really use the potential advantages of enlargement.