FROM CONTROL TO MARKET – AUSTRIA'S EXPERIENCES IN THE POST-WAR PERIOD

DECEMBER 3 TO 4, 1990
WARSAW

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Editor

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Oesterreichische Nationalbank

OESTERREICHISCHE NATIONALBANK

Industrial Policy in Austria - Historical Review and the Current Privatization

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(1) Austria is a country with a relatively large industrial sector, its productivity is catching up with the leading industrial countries.

The proportion of gross national product originating from the industrial sector is 27%. Among the leading industrial countries this share is larger only in Japan and Germany.

The productivity of Austria's industrial sector was trailing West German productivity by one quarter to one third just one or two decades ago. In 1990 Austria reached German productivity. In this year alone Austria's productivity jumped by 6%, West-German productivity rose by 3% only. Seen from the perspective of the 1950s and 1960s this catching up process seemed impossible or at least improbable.

(2) Industrial policy in Austria is a set of complex rules; responsibility rests with different governmental departments or political institutions. It is a pragmatic approach rather than a consistent strategy.

Only in the very first years after World War II did Austria have some sort of medium term planning, partly in connection with the restructuring of its nationalized industry, partly with the European Recovery Programme. Many relevant decisions are byproducts of decisions of social partners (trade unions, chamber of commerce, agricultural agencies) shaping the environment for wage negotiations, incomes policy, stabilization of macroeconomic conditions. Industrial policy does not follow an ideological concept or a long term vision, but is a part of wide range stabilization policy, stabilizing climate and conditions of consumption and investment, reducing uncertainty.

(3) Wages and prices had been regulated according to different rules and regimes during the post-war period. In general, Austria also tried to keep down wage pressure and price increases a bit more than its neighbour countries. This opened the way for higher investment and better infrastructure and finally for a more innovative economic policy.

Inflation is a crucial problem in any phase of reconstruction. Five price and wage agreements (1947—50) tried to restrict wage and price pressure in a period of insufficient supply. Despite the centralized nature of the negotiations and their endorsement by economists, the life time of each agreement was shorter than that of its predecessor. Political unrest came up, a "new policy" was called for.

This final step of stabilization policy started with a demonstrative announcement of an absolute cut of some crucial prices to break inflationary expectations. Restrictive budgetary and monetary policy were added to make this policy credible. Liberalization on domestic markets and the abolition of import barriers kept inflationary pressure down.

Furtherance of supply was not forgotten either. Accelerated depreciation for investment in machinery and lower income taxes were announced to encourage supply. Infrastructure investment (communications, railways, highways) increased external competitiveness and intensified internal competition at the same time.

Cooperation between the social partners was institutionalized in the 1960s. A joint commission ("Paritätische Kommission") was established to supervise price and wage increases in a rather centralistic way. Rules for when to start wage negotiations and to allow price increases were fixed. Economist have differing views on the long run consequences of these mechanisms, but at least they delayed wage and price increases and cut off their peak.

This may be called a voluntary scheme without explicit price fixing by government, but it worked seemingly better than any legal price fixing. Each social partner monitored its clientele in a much more comprehensive and successful way than government bureaucracy would have been capable of doing.

The cooperation of the social partners was supported by a board of experts ("Beirat") who supplied the analytic basis for the negotiations and could be called as arbiter in case of conflicts. After normalization the rules were increasingly applied in a softer and less comprehensive way, but could be referred to again in periods of supply shocks or increasing inflation.

(4) To a larger degree than in other countries are economic policy measures shaped by centralized interest groups, especially the social partners. Their influence on prices and wages, on subsidies, on technology policy, even on cultural policy and education is quite large. They implicitly or explicitly share some beliefs or agree on certain rules, which helps to solve critical situations and widens the range of feasible policies.

They share the belief that production is more important than distribution. Production is considered a precondition of distribution. A slightly lower share of wages is not seen as an immediate source of extra profits, but as a financial basis for higher investment. If some extra profits accrue and are not reinvested, this will be a decisive argument for an extra increase in wages in the next round of negotiations.

They share the belief that competitiveness of firms is the only way to earn incomes, that import controls are not feasible (by the way, they would help distributors more than producers).

They share the belief that modernization and rationalization will not primarily set free workers, but will allow capacity increases.

And they know that in case of any vital threat to one's position and income, there will be a way to regain lost incomes.

Let me give you an example. In the 1970s inflation and unemployment were common problems for industrial countries. Austria pursued a strict hard currency policy. Appreciating the Austrian Schilling kept inflation down and allowed government to be less restrictive as far as fiscal policy was concerned. To tolerate this policy of a potential profit squeeze it was necessary for firms and employers to know that wages would not climb too fast and that interest rates would not become too high. Both conditions could be relied on and Austria could pursue a more complex, less restrictive strategy for a longer time than other countries.

(5) The nationalized part of Austria's production is larger than in other countries. In addition many sectors are regulated and/or indirectly owned by non-profit organizations.

Fifteen per cent of manufacturing occurs in nationalized large firms (called "the nationalized industry"). Nationalization has historical roots. Preventing the "Allied Powers" from taking hold of former German firms was one reason. Some people also favoured nationalization as a means of developing a new (socialist) order; a more pragmatic reason was lack of private capital and owners.

The majority of Austria's largest banks are nationalized, they have their own production firms in the manufacturing sectors (these are called indirectly nationalized firms), some cooperatives (e.g. in the food sector) are to be added, some state monopolies (tobacco, salt). Taking all these forms together, one fourth of the manufacturing sectors has no private owner.

One third of value added in manufacturing is produced in foreign owned firms. There are very few private large firms with domestic owners and active direct investment abroad. Austria has a large and very competitive sector of small and medium sized firms.

(6) The principles for management or the objectives of nationalized firms have never been explicitly defined. Actually pursued goals have varied, the same is true for organization and management structure.

Whether goals of nationalized firms differ from private ones has been controversial. In optimistic days some people (and politicians) demand nationalized firms to be spearheads of technological progress or innovators in shopfloor democracy and codetermination, in pessimistic days they demanded stabilization of employment. But neither of these aims was defined or written in any law or charter.

The decision-making process and the degree of influence by government changed over time. Often some department of government was directly responsible for the decision of firms (including investment plans), usually some intervening agency was constructed. The recruitment process for top management favoured political selection, the quality of management was of secondary importance.

For a long time the performance of nationalized industry did not differ from that of private industry. Sometimes it looked even as if nationalized industry performed better than foreign private industry (in similar branches). In relation to Austrian private industry sales, employment and exports rose even faster. Profits, however, lagged, but that was not seen as a surprise since the tide turned against basic goods, the core of our nationalized sector.

A vital crisis for Austrian nationalized industry (with large losses) ocurred in the mid-1980s, demanding radical restructuring. If today we list the reasons for the crisis, we would rank centralistic and bureaucratic organization and bad management in the first place. Divisionalization, profit responsibility, personal incentives for workers and management were absent. Some people assess this as typical for nationalized industries. Others would like to keep bad organization and nationalization apart. Political influence on recruitment of management and political interference in the decisions of firms are more typical for nationalized industries.

The reform of Austria's nationalized industry took several steps:

— first the decisions of the firms were seperated from government by setting up a holding company. Its board is still nominated by government, but without reference to the political background of board members. Several of them are managers of private firms;

— firms were regrouped into divisions. Within companies smaller units with profit responsibility were created. The nationalized firms now work pretty similar to private firms, investing in Austria and abroad, from time to time restructed according to profit chances and demand shifts;

— denationalization was up to now no central element of the strategy. Of course some minor firms and divisions were sold, some minority shares of one large company were sold. The holding company issued option bonds (Optionsanleihe), which were to prepare the issuing of stock two or three years later.

We try — and up to now this seems feasible — first to restructure the firms and eventually to decide whether to sell them or not and not to prepare them for immediate sale.

The discussion on the ultimate goal of nationalization is not yet decided. Today — as a specific response to the crisis on the one hand and because of the favourable business climate — nobody wants nationalized firms to behave differently from private firms. I doubt whether this line will remain feasible under less favourable conditions.

If I have to sum up our experience with nationalization I would like to stress the following points:

— nationalized firms can be quite successful for a long period, especially if they produce in branches with large economies of scale, if workers are highly motivated and if there is some incentive (pecuniary or other) to achieve high standards —

— if they have to stay competitive in the long run, they have to copy many if not all elements of private firms. A definite goal like profit maximization or at least some other quantitatively defined goal is to be set. Incentives for workers to increase efficiency, incentives for managers to apply and develop modern technology have to be set, flexibility to react very quickly to demand changes (including dismissal and bankruptcy) must be monitored —

— political influence on management and soft budget constraints have to be eliminated from the outset.

— This does not mean that there is no way to influence the behaviour of nationalized firms in a consistent and well defined way. Contracts between governments and nationalized firms (as well as with private firms) are feasible if the nature of the intervention, its cost and revenues are well defined. A special intervention to develop some technique to merge with a certain ailing firm is feasible, but its costs and benefits should be forecast, monitored and financed in a distinct way. Implicit contracts in the sense of doing something reluctantly today, and expecting something undefined tomorrow in exchange destroys economic efficiency and competitiveness.

(8) An important problem ahead for Austria is the implementation of goals and controls in that sector of the economy that can or should not be privatized and in which there is no competition.

Hospitals, schools, central agencies and the local bureaucracy consume the lion's share of Austrian taxes. Objectives are undefined, performance criteria not operationalized, costs are high, efficiency is low. The share of this sector in GNP and its importance for welfare and competitiveness is even larger than that of nationalized industry.

(9) Austria has been and is open to foreign investors but had not been open in a naive and uncritical way.

More than one third of our manufacturing sector is owned by foreigners or foreign firms. There is a certain upper boundary to foreign influence on the one hand because of the nationalized sector, on the other hand due to the important sector of small and medium sized firms.

Foreign capital and internationalization of management methods were crucial for the catching up process, as was the direct import of technology embodied in investment goods in the first post-war period. Today we try to limit foreign capital indirectly by fostering technological improvements, active direct investment abroad, and some restraint in the subsidization of foreign subsidiaries. But we still have fewer formal restrictions against foreign investment (like golden shares) than other open small countries.

(10) Austria made intensive use of the instrument of investment subsidies to modernize and boost investment and growth. We had very generous schemes to accelerate depreciation (up to 80% in the year of investment) for machines, firms came near to be freed from any kind of incomes tax as long as they invested (at an increasing rate). In the 1970s we relied heavily on investment subsidies to cut interest rates, for small firms as well as for large firms. The industrial sector and production in general were privileged by these instruments.

Though we curbed subsidies and stopped accelerated depreciation in the 1980s, we think it was extremely useful to encourage internal finance and investment in periods of supply bottlenecks and of lacking stock market. Taxes lost were paid back with high interests to government by the growth process.

Accelerated depreciation means a larger deduction from profits than that due to economic depreciation in the very first year. It is a powerful incentive for firms to invest (since investment saves taxes). It is a powerful incentive for managers to resist excessive wage claims (which are otherwise a method of tax saving). It is a guarantee for workers that wage restraint does not lead to luxury consumption of the owners or side payments to the managers, but to increased productivity and competitiveness of the firm.

(11) Vocational and shop-floor training is the second source of higher productivity. We have a dual training system for young people, partly in firms and partly in vocational schools. The people are trained by the firms (between 15—18), and in this period are very cheap workers for the firms. Complementary training is done on one or two days a week in schools. We have the feeling that this system is superior to several alternatives in other countries.

(12) Industrial policy is not pursued according to a strategic concept, it is rather pragmatical, sometimes even casual and incoherent. But it always looks at the demand side as well as to the supply side and reduces economic uncertainty.

A prominent part is carried out by very centralistic social partners, who are also integrated into the political process and structure. The partners in economic life know that whatever problem comes up, industrial policy will try to face the most important needs and thereby soften the risks. Supply will be encouraged even at the cost of revenues, demand will be stabilized even at the cost of budget deficits. If wages are kept down, the surplus will be used for investment and not for luxury consumption, if profits are squeezed, this will be considered in the next wage negotiations.

The "macro-insurance" serves to encourage technological progress and rationalization at the micro level. International competiveness in an open economy is the goal and productivity increase is the precondition. If some workers will not be needed in one department any longer, growth of other departments will be high enough to employ them. *Production in general and manufacturing is the core of the economy.* A large part is done in small and medium sized firms. Large (and nationalized) firms are complementary and can be successful if they are run by excellent managers and according to modern principles of organization. Promoting mergers or creating private monopolies (e.g. by the privatization of state monopolies) does not guarantee success. Large firms are in danger of becoming centres of X-inefficiency if they are not persistently contested by foreign competition and/or small dynamic entrants.

(13) Industrial policy does not mean planning, nor government interference at the level of individual firms. It sets the right incentives and supplies the perspective of warranted development.

All countries perform some sort of industrial policy, especially in phases of restructuring. Japan and the USA have their own kind of industrial policy, in Japan it is done by MITI, in the USA it is a mixture of research efforts in the military sector and in the universities, tax credits for investment were the base of the current economic upswing, Chrysler's subsidy and the current efforts to save ailing banks are other fields of intervention. A good industrial policy should be made explicit and performed in a strategic way. If this is not done, industrial policy happens as an inconsistent byproduct of financial and administrative decisions of different government agencies.

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