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Comparative advantage, regional specialization and income distribution: The case of Austria in perspective

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Abstract

Realization of comparative advantage (David Ricardo) raises issues of income distribution that emerge when specialization gains are achieved. While the Stolper-Samuelson theorem 'predicts' that because of trade liberalization in 'rich countries' like Austria or Germany wages may fall and real incomes of capital owners might increase, some doubts are raised whether continuous cuts in relative wages – as a response to specialization gains achieved in the process of trade liberalization – are an adequate policy response. The case of Austria illustrates the related issues. This case it not representative for the EU at large, a similar result can be expected for a few other EU countries, e.g. Germany. Other EU member states pursue different policies.

JEL classification: F16; F14; E65; E64; E24

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1. Introduction

The Austrian economy is perceived as a major winner of 'Eastern enlargement' of the European Union, but Austrians' perception of the usefulness of EU membership is the second lowest within the European Union: 36% perceive membership as good, 37% as neither good nor bad, and 23% as bad. Only in the UK less people find EU membership as useful: 34% (Eurobarometer, 2006, p. 19). Similarly, only 31% of Austrians are in favor of further EU enlargement, and again there

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is only one country where even less people are in favor, 30% in Germany (Eurobarometer, 2006, p. 50). How come that a large part of the population of a country, which in 1994 had a 66% vote in favor of accession and which is perceived as a major winner of trade liberalization in course of EU enlargement, finds EU membership to be of limited usefulness and is rather skeptic about the possible effects of further enlargement?

To answer this question the paper proceeds as follows. After this introduction the main results from various studies on Austria's EU accession and on EU enlargement are summarized. Next, the effects of Austria's EU membership on incomes of workers are described. Then, after a brief reference to standard theory (Ricardo and Stolper-Samuelson) I show a simple numerical example, which helps to understand the conflicting views on undoubtedly positive effects of trade specialization according to Ricardo's 'Doctrine of Comparative Costs'. Finally, I try to draw conclusions about the risks, which emerge from the chosen path of incomes' policy.

2. EU accession and enlargement effects

EU enlargement seemingly has come close to becoming a continuous process. In the last 13 odd years 15 mostly small countries became new EU members, and yet two more have achieved the status of being 'candidate': Croatia and Turkey. 14 of the current 27 member states share the Euro as a joint currency, and more would like to in a not too distant future. While the EU with 27 member states has become the world's largest Regional Integration Agreement with close to 500 million inhabitants, the drive for global trade liberalization lost momentum, as can be easily concluded from a brief look at the at best very modest progress achieved in the Doha Development Round. Regional Integration Agreements seemingly serve as a highly welcome substitute for little achievements at the global level. Due to various free trade agreements and a customs union with Turkey the effects of EU integration reach far beyond the 'narrow' circle of the 27 EU members. The System of Pan-Euro-Mediterranean Cumulation covers 42 member states and nearly half of world trade (including intra EU-trade). It was introduced in 1997 and substituted for the previously separate rules. It allows cumulating 'country of origin content' among its members without impeding the customs free status on their respective markets, most notably the EU market.

Considering the regional integration efforts in North and South America, and in other world regions it is no big surprise that a vast body of literature studying integration effects has emerged since the seminal work of Viner (1950). Breuss (2007) in his attempt to develop a 'grand unified theory' summarized the literature and identified a set of general and EU specific integration effects. We follow his structure of arguments. Major integration effects can be grouped into the categories allocation of resources (*trade and scale effects*), *accumulation effects*, and *location effects* including factor movements.

Trade effects embrace the famous Viner (1950) concept of trade creation and trade diversion. Foreign trade may increase, because cross border transaction cost will be reduced, and may be diverted from other destinations, because integration reduces trade cost only within the integration area and usually not with countries remaining outside. If a large country is trading with small countries then imperfect competition may allow the large country to influence price setting and by that have an impact on the terms of trade.

Scale effects (Corden, 1972): Under imperfect competition firms located in small countries may have a chance to ripe benefits from increasing returns to scale, because in course of an integration process they get access to larger markets. That effect may be less pronounced