

DOING BUSINESS IN Austria

F1, fizz and folklore

Ed Hammond visits Red Bull's volcano-shaped head office and imbibes the wisdoms of its co-founder
Page 4



FINANCIAL TIMES SPECIAL REPORT | Wednesday September 28 2011

www.ft.com/austria-2011 | twitter.com/ftreports

Economy thrives as politics stalls

In spite of popular discontent and a sense of fatigue in the ruling coalition, business is in surprisingly fine fettle, writes **Haig Simonian**

The resignation this month of Wolfgang Schüssel from parliament marked the end of an era in Austrian politics. But while the decision by one of the country's most seasoned statesmen to step down represented a watershed, it is hard to define a clear successor period.

Since the defeat of Mr Schüssel's Austrian People's party in the 2006 elections and the onset of grand coalition governments, the country has been in limbo. Lawmaking has continued, but without significant progress – and the defining changes introduced by Mr Schüssel's controversial coalitions with Austria's far right have not been followed through.

What has emerged is a profound sense of public discontent and frustration with politics in general and specific issues, such as relations with the European Union or immigration, in particular. The lack of progress and regular bickering in the two grand coalition governments of People's party and Social Democrats has prompted a marked deterioration in popular perceptions of Austria's politicians.

"Like the Habsburgs in their final days, Austria's political class is evidently fatigued, unable to stimulate innovation and to tackle overdue social reforms," says Armin Thurnher, editor of the Falter weekly magazine and a familiar social commentator.

Most recently, popular



Vienna port on the Danube: the resilience of foreign markets has been a boon for Austria's exporters

Alamy

cynicism, indeed contempt, has been stoked by corruption scandals involving former ministers and advisers from the Schüssel era, suggesting that even this period, whatever reforms it brought, may have to be reassessed.

Even the current chancellor, Werner Faymann, was this month confronted with suggestions that too much public money was directed to advertising in tabloid papers when he was transport minister.

Public opinion has been further bruised by economic crisis. After 2009, the economy faltered, unemployment surged and some of Austria's banks needed state crutches. But instead of anticipating problems or seeking bold solutions, the grand coalitions seemed reactive, even passive, in their response.

"The government's work has been much more constructive than depicted in the media", contends Maria Fekter,

Austria's finance minister, and deputy chair of the People's party, who is responsible for her party's smooth relations with the Social Democrats.

"A lot of things have been done well together. But the media is obviously more interested in the negative side." However, even Mrs Fekter acknowledges: "We are two different parties with two differing ideologies."

Mr Thurnher traces popular disenchantment with politics

back to Austria's re-establishment after the second world war and the postwar stress on stability and neutrality. But whatever the historical antecedents, the lack of dynamic has become impossible to miss in the recent grand coalitions.

The near paralysis in politics has fuelled discontent, the latter expressed either in rising support for the far right or by an increasingly depoliticised youth. "The two ruling parties have no incentives whatsoever to take

risks. Their feeling is that whoever makes the first move will be punished for it at the polls," he says.

Dissatisfaction with the government has filtered through to the business establishment, normally loyal to the People's party and seldom critical in public. In outspoken comments, senior business leaders have chastised the government's inability to address crucial issues.

With debt rising and jittery markets, pensions reform tops most business leaders' list of areas for urgent action. Education and broader administrative reform – the latter dating back years – also remain acutely in need of attention.

Administration is the real chestnut, because of its direct influence on business. Austria's population of 8m is no bigger than that of neighbouring Bavaria. But the country has nine federal states with their own administrations and rules. Duplication, whether between federal government and states, or between the states themselves, is recognised as wasteful and inefficient.

Recently, one state, Steiermark, has tried to reform. But most calls for change have foundered on opposition from deeply entrenched vested interests. Yet in spite of the popular misgivings, Austria remains in surprisingly fine fettle.

The economic downturn proved shorter than expected, thanks largely to the speedy recovery of neighbouring Germany, Austria's main trading partner, and the resilience of more distant foreign markets for Austria's entrepreneurial exporters.

Growth has been restored to a level comfortably above most

Continued on Page 3

Inside this issue

Politics Squabbles in the coalition between the Social Democrats and the People's party are putting a brake on reforms demanded by industry leaders **Page 2**



Banking Exposure to southern Europe is small but the biggest headache for Austria's banks is Hungary **Page 2**

Opinion The political courage to implement structural reform has been lacking, says former finance minister Hannes Androsch **Page 2**

Business climate Observers say the economy has held up in spite of Austrian politics, not because of it **Page 3**

Infrastructure Bottlenecks are being eased on the roads and rail, although some train tunnel projects are hard to justify **Page 3**

Industry Neighbouring Germany's booming industrial sector is keeping manufacturers busy **Page 3**

Federalism The system is popular but duplication is costly; interview with Markus Wallner (above), deputy premier of Vorarlberg, Austria's westernmost state **Page 4**

Continued on Page 3

Iron Lady steeled for 'solid programme' to reduce debt

Interview
Maria Fekter

Haig Simonian meets Austria's new finance minister

Maria Fekter, Austria's finance minister since April, seems relaxed compared with many of her eurozone colleagues.

Unlike most neighbours, the country's debt is under control, unemployment is modest and growth looks good. Even the often critical Organisation for Economic Co-operation and Development, the rich nation's club, rated Austria favourably in its most recent report.

But Mrs Fekter, a 55-year-old career politician, knows she cannot rest. While praising Austria's relatively open and flexible economy and broadly business-friendly policies, the OECD chided the government for not acting faster to reduce debt, as it could no longer rely on exporters and strong growth in eastern Europe.

"We were able to maintain employment through the crisis thanks to temporary working schemes and special packages, meaning we could make good the damage within a year," says Mrs Fekter in an interview in the finance ministry's temporary headquarters, pending refurbishment of its usual home.

"We have the lowest unemployment in the eurozone and we've been especially successful in keeping youth unemployment down. Our apprenticeship system is recognised as preparing young people well for working life. To be honest, the youth unemployment data are more important to me than any educational rankings."

Mrs Fekter is unusual in a government castigated for its lack of business expertise. After studying



Maria Fekter: Austria has big advantages for business

Getty

law and business at university, she joined her family's gravel extraction and transportation business, eventually becoming managing partner. "It's a good basis for a finance minister," she says.

That experience, combined with a distinctly populist touch, has turned her into a political rising star, in spite of her lack of a formal financial background. After 13 years in parliament, most of which were also spent chairing the judicial affairs committee, she was appointed minister of the interior in July 2008. After Josef Pröll's surprise resignation as finance minister earlier this year, Mrs Fekter progressed further, having already been elected deputy chair of her Austrian People's party the previous November. Some see her as a future party leader and chancellor.

Austria, says Mrs Fekter, has three big advantages as a business centre. "First, we didn't have a property crisis, thanks to a good mix of government policies giving rights to tenants and landlords. Second, we can offer real security: crime is low and there is legal certainty, both invaluable to business

and investors. And finally, we have an enormously high quality of life, there is real prosperity, and Austria is an immensely attractive place to live."

The stress on law and order is telling. As interior minister, Mrs Fekter became known as Austria's "Iron Lady" for her emphasis on fighting crime. "The media wanted to make it sound negative. But I've always preferred to see it as a compliment," she says.

Born in Attnang-Puchheim, a village in Upper Austria, Mrs Fekter went into politics at 30, joining the local town council. Four years later, she made her national debut, serving for four years as secretary of state in the economics ministry.

Mrs Fekter acknowledges debt reduction is the key task in her current role. "This is the area which as finance minister concerns me most." But she stresses she will avoid knee-jerk reactions. "We can only address this through

growth and good economic management, through a solid and determined programme to bring down the debt," she says. The latest numbers look promising. The forecast for a government deficit this year of 3.9 per cent of

gross domestic product should be bettered: the latest numbers suggest 3.3 per cent. In 2012, the aim is to be below 3 per cent and to decline progressively thereafter.

Mrs Fekter admits many reforms are overdue, notably on pensions, and particularly the early retirement rules designed for workers in heavy industry but now abused by civil servants and white collar employees. As a result, the average retirement age has slipped to just 58.

She recognises such legislation will be unpopular, especially in a grand coalition government, whose two constituents compete as well as co-operate. "Getting these concessions reversed is very difficult. We have done so partially by other measures."

Her tone remains moderate throughout – highlighting the political realities of working in a coalition and the reluctance of both governing parties to initiate anything that might advantage the other. "We are trying to regain ground. But I think it's also important not to come up with a new idea every day."

Where she becomes more visibly party political is on the Social Democrats' plans for new or higher taxes.

Proposals for a wealth tax are "incomprehensible", she says, accusing the Social Democrats of latching on to "the envy debate".

She is as scathing about their suggestions to abolish tax breaks that have conspicuously boosted Austria's appeal as a regional headquarters for foreign companies. "This model has been enormously successful – so much so that other countries have copied us. The danger of all the talk about new taxes is that we are causing uncertainty and potentially scaring away investors," she warns.

Trust in a bank that has its roots in Austria and a strong franchise all over the world starts right here.

And because of this trust, it is MY BANK.

Recently established Raiffeisen Bank International is Austria's 'most international' bank operating the largest network of any foreign banking group in Central and Eastern Europe. It is also the only Austrian bank with a presence in both the world's financial centres and in Asia. And it is embedded in Austria's largest banking group, which additionally bolsters its stability and soundness. www.rbinternational.com

Doing Business in Austria

Squabbles in coalition put brake on reforms

Politics

Eric Frey finds that constructive deals between partners are in short supply

The Social Democrats and People's party jointly hold a stable majority of 108 of 183 seats in the current parliament and face no national or regional elections in the next two years.

But instead of undertaking the economic reforms that economists and international organisations such as the Organisation for Economic Co-operation and the International Monetary Fund call for, the parties are stuck in a cycle of political infighting where they try to score points off each other.

Even though the two coalition leaders, chancellor Werner Faymann from the Social Democratic party and Michael Spindelegger from the conservative People's party, are both soft-spoken pragmatists who get on together, the dynamics of day-to-day politics often hinder constructive compromises.

The backlog on key issues, including changes in the expensive pension system, education and health reform, angers business leaders. "We need more positive impetus from the government so that we can handle the coming challenges," says Veit Sorger, president of the Federation of Austrian Industries.

The key areas of dispute are the military draft, which the

Social Democrats want to see abolished, pensions, tax policy and the troubled state of the public universities.

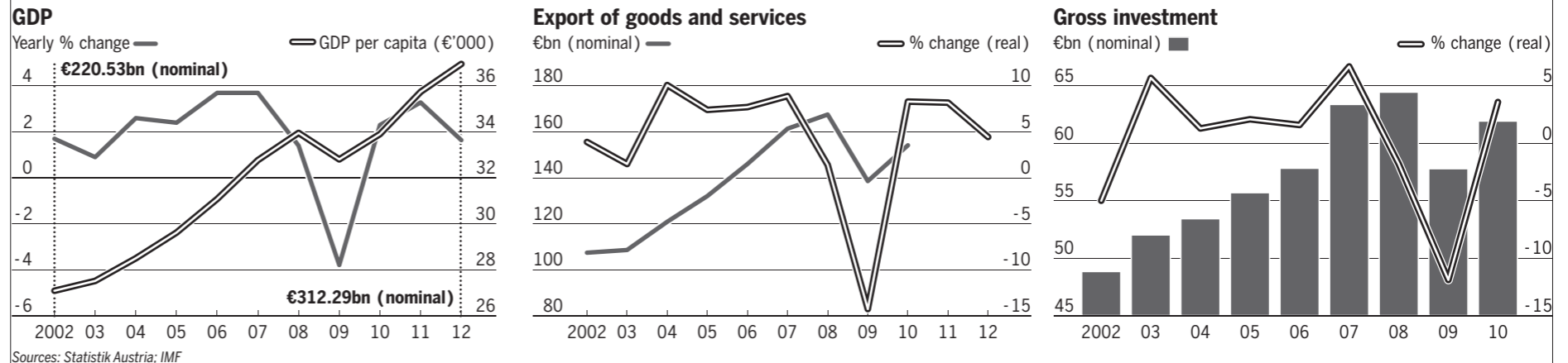
The two parties are deeply split on how to help the public universities that are overcrowded, partly through the influx of German students, and starved of funds. The People's party wants annual tuition fees of about €1,000 to limit enrolment and open new sources of funding and also calls for general admission tests in the most popular departments.

But the Social Democrats, who cling to the ideal of free and unrestricted higher education, demur. The victims are students and teachers who see the quality of university education decline.

On pensions, the People's party wants to abolish the remaining options for early retirement quickly, while the Social Democrats prefer a slower process that would lift the average retirement age, currently 59 for men, gradually.

The most controversial issue is the repeated call by the Social Democrats to introduce a wealth tax to reduce the budget deficit and the gap between rich and poor. The People's party is strictly opposed, citing the existing high taxation levels on income and the recent introduction of a capital-gains tax on securities. But the issue has helped to lift the Social Democrats in the polls and put Mr Spindelegger on the defensive.

The controversy about taxes, which mirrors similar debates in other countries, is hurting Austrian business, says Andreas Treichl, chief executive of Erste



Sources: Statistik Austria; IMF

Group, a big bank. "We will see a loss in our prosperity if the political leadership does not make clear decisions that can give workers and investors confidence about the future," he says.

Mr Spindelegger, the foreign minister, became party leader and vice-chancellor in April when his predecessor Josef Pröll resigned, officially for health reasons, but also to escape constant sniping against him from his own party. But Mr Spindelegger is less popular than Mr Pröll and has failed to unify the party behind him. His People's party is stuck in third place in opinion polls, behind the Social Democrats and even the far-right Freedom Party.

The conservatives are also hurt by corruption charges from the years 2000 to 2006, when their former leader, Wolfgang Schüssel, was chancellor.

Most of the reported incidents, including alleged kickbacks related to the purchase of Eurofighter jets by the military, privatisation schemes that are now under judicial investigation and corruption charges against Telekom Austria, a partly state-owned telecom group, involve former members of the Freedom Party and its small spin-off, the Alliance for Austria's Future (BZÖ), which were both Mr Schüssel's coalition partners.

The former chancellor is not implicated, but has been criticised for lax supervision.

The issue that causes most controversy is the repeated call by the Social Democrats for a wealth tax

The central figure in most of the scandals is former finance minister Karl-Heinz Grasser, who switched over from the Freedom party to the People's party in 2002. He is under investigation in several cases, but has not been officially charged with any wrongdoing. The People's party is bearing the brunt of public anger.

Heinz-Christian Strache, Freedom Party leader, says he has cut all links to the old guard and bears no responsibility. His party was riding high in the polls thanks to widespread anti-foreigner sentiment, anger over the bail-outs for Greece and other eurozone partners and the weak performance of the government.

The party's ascent was slowed only last summer when a key regional official was convicted for offering favours to a Russian investor in return for donations to his party. Uwe Scheuch, who leads the Freedom party in Carinthia, is appealing against the verdict and has not resigned.

Still, there is widespread concern that the Freedom Party, which garnered 17.5 per cent of the votes in the last election, could move ahead of the Social Democrats and win the next general election, due in 2013.

So even if Mr Faymann and Mr Spindelegger fail to bridge their differences, that fear stops them from considering snap elections and holds the coalition together.

€5bn loans to Hungarians are biggest headache

Banking

Southern European exposure is small but a controversial move by Budapest is causing concern, writes Eric Frey

Two years ago, the major Austrian banks were among the most vulnerable institutions in Europe because of their huge exposure to central and eastern European countries that were under pressure from recession and falling exchange rates.

But as the economic crisis shifted to southern Europe, Erste Group, Raiffeisen and Bank Austria, a unit of Italy's UniCredit, are now in a relatively comfortable position. Their exposure to sovereign debt in Greece, Spain or Italy is comparatively small, and their core business in the CEE region has picked up again from the 2009 lows.

"There is always a risk of spillover" from the southern periphery to the CEE region, says Andreas Treichl, Erste Group chief executive. "But there is also a growing consensus that once growth does return to Europe, it will certainly happen in the east."

Austrian banks built up large reserves to account for the larger risk in their CEE loan portfolios and analysts generally see no need for significant new charges against earnings. Worries about a possible credit crunch for small- and medium-sized companies have also receded over the past two years.

But, like other European banks, they will need to raise new equity capital in the coming years to meet the tighter requirements imposed under the coming Basel III regulations.

Still, Erste Bank and Raiffeisen are eager to repay the government the participation capital that was injected after the collapse of Lehman Brothers three years ago. With annual dividend payments of 8 per cent, it is far more expensive than equity from private investors.



Reserves of strength: a branch of Erste Bank in central Vienna

The biggest headache for Austrian banks is currently Hungary, where the right-wing government of Viktor Orbán pushed through a law that allows holders of foreign currency loans to pay back their debt at a favourable exchange rate.

The controversial measure is expected to hurt Austrian banks, which had made €5.4bn (\$7.4bn) in Swiss franc loans in Hungary alone, many of them to households that are now struggling to keep up with interest payments due to the sharp rise in the Swiss currency.

"This is a major problem that we are trying to solve," says Mr Treichl. The way out, however, must be through mutual agreements between the commercial banks, the central banks and the debtors, "and not through state intervention", he adds. The actual costs for the banks will depend on how many debtors will be able to exercise the option, which will require repaying the outstanding loan in full.

Other CEE countries with large foreign currency loan exposure could be tempted to follow the Hungarian example and relieve their citizens at the expense of

foreign banks, warns Markus Heidinger, a lawyer who specialises in banks. "That is why the banks will fight tooth and nail" against the Hungarian law, he says, referring to possible legal action in Hungary or at the European level.

The trouble spots in Austria's banking system are with three mid-sized banks. Kommunalkredit and Hypo Alpe-Adria were national-

ised after the Lehman crash and have not yet recovered, and Österreichische Volksbanken (ÖVAG) failed the European Union-wide stress test this summer.

None of these banks is going to go bankrupt and threaten the country's financial system, says Mr Heidinger. "The question is only the size of the bill for the taxpayer and the possible damage control."

Hypo Alpe-Adria, formerly owned by Bavaria's

Bayerische Landesbank and the province of Carinthia (Kärnten), is the costliest holding for the government. Some analysts say the bank has made little progress in selling assets and creating reserves for troubled loans that were extended mostly in Croatia and other Balkan states. Judicial investigations into the previous management are believed to be holding back the bank from more radical restructuring.

ÖVAG recently agreed to sell its international branch ÖVI to Russia's Sberbank for at least €585m, less than ÖVAG's original valuation. Sberbank paid only the equivalent of ÖVI's equity capital, which did not provide the troubled bank with additional reserves.

ÖVAG's key weakness is the failure of its owners, the co-operative Volksbanken, to agree on a strategy, says Mr Heidinger. Earlier plans to merge ÖVAG with Bawag PSK (the former trade-union bank now owned by the US equity group Cerberus) fell through because of resistance in the sector.

The government may force a sale of the bank, however, in case it is required to save it with a fresh capital injection.

Debt burden weighs on future prosperity

Opinion

HANNES ANDROSCH

Austria's development since the second world war is a true success story. But today the country is confronted by major challenges in preserving its prosperity and security.

In 1945, Austria was poverty stricken. Between 1948 and 1953 under the Marshall Plan, almost \$712m was invested in Austria to lay the foundations for the transformation of industry, its growing prosperity and the availability of a wide range of social services. From 1953 to 2000, consumer prices rose sixfold. But incomes jumped by a factor of 20. In 2005, prosperity reached a peak, with Austria ranked sixth among the 34 members of the Organisation for Economic Co-operation and Development.

Then in 2008 came the global financial and economic crisis after the Lehman Brothers collapse. Hit hard, Austria launched a comprehensive €100bn (\$137bn) rescue package to prop up its banks. In 2009, as gross domestic product fell 3.9 per cent, Austria experienced its third, and its most severe, year of recession since the war – although a strongly counter-cyclical fiscal policy alleviated the worst of the pain.

Speedy economic recovery came thanks largely to Austria's pronounced export orientation. Foreign sales should reach a record of about €120bn this year, due in no small measure to favourable developments in unit wage costs and productivity gains. The economy is expected to grow by about 3.2 per cent in 2011, taking GDP to about €295bn.

But the crisis is not over. The consequences of past neglect are already beginning to show. The cost of the expansionary packages in the aftermath of the Lehman collapse are

becoming apparent in the sovereign debt problems emerging on both sides of the Atlantic.

Budgetary challenges have also been ignored in Austria for far too long. Sometimes we have had attempts to camouflage the true state of public finances by outsourcing sectors of the budget, along with the associated debt. The political courage to implement structural reform has simply been lacking. The International Monetary Fund has criticised excessive expenditure, as well as the lack of will – especially on the part of the federal states and local councils – to reform.

Expenditure on health, currently 11 per cent of GDP, is too high. The OECD sees an urgent need for reform in the pension system. Unemployment of 4.3 per cent may be the lowest in the European

2010. It must remain Austria's top priority to create an educational system that is modern and forward-looking, a system that can span the spectrum from kindergarten to university and incorporate training programmes as well as further education.

The government has committed itself to making the country an innovation leader by 2020. That is the only hope of ensuring Austria maintains its competitive position and can compete in European and global markets.

This goal, however, can be achieved only when adequate financial resources are invested in education, science and research. But, for the past three years, all we have witnessed is budgetary stagnation, with no sign that matters will change.

A serious threat is being posed by Austria's future by the continuing inability to consolidate public finances and halt growing national debt. When we include segments of the public sector and their indebtedness that have been outsourced from the budget, national debt has increased dramatically, from €133bn in 1999 to €260bn in 2011.

Moreover, the two banks that had to be nationalised to avert their collapse have liabilities of €36bn between them. All told, Austria's debt-to-GDP ratio lies in the region of 100 per cent – far above the European Union's Maastricht criteria, which envisage an upper limit of 60 per cent.

Austria has experienced a period of remarkable development and is well positioned to enjoy a successful future. But it will take a major effort to maintain the much admired quality of life we enjoy. To safeguard this future, we will have to modernise and overcome institutional "gridlocks" and the blocking tactics of "refuseniks".

Hannes Androsch is an Austrian entrepreneur and consultant, and a former Austrian finance minister.



'For the past three years, all we have witnessed is budgetary stagnation'

Contributors

Haig Simonian
Switzerland and Austria Correspondent

Ed Hammond
Property Correspondent

Eric Frey
FT Contributor

Andrew Baxter
Commissioning Editor

Philip Parrish
Sub-Editor

Steven Bird
Designer

Andy Mears
Picture Editor

For advertising details, contact: **Gerd Roessler**
Phone +43 1 897 36 00
36, Fax +43 1 897 36 00
38, Email office@
financialtimes.at
or your usual Financial Times representative

All FT Reports are available on FT.com. Go to: www.ft.com/reports

Coalition's internal strife fails to deter inward investors

Business climate

Workforce harmony and skills remain key attractions, says Haig Simonian

It has become fashionable among Austria's chattering classes to talk of the "Italinisation" of their country. While political life lurches forward, constrained by internal conflicts, inadequate courage to take initiatives and now corruption probes, business flourishes. Austria had a relatively "good" crisis, coming out of the slowdown sooner than expected and with exports surprisingly robust. Proximity to Germany, which enjoyed a steep upswing, helped. But broader foreign sales showed resilience too, even if domestic demand

remained subdued, says René Siegl of the Austrian Business Agency, the inward investment body.

Business leaders argue that the economy has held up in spite of Austrian politics, not because of it.

"There's an immense sense of frustration in the business community. We have a structure where you cannot impose any changes because the two coalition parties are blocking each other. Each is hoping it will become the strongest party after the next elections, but those are two years away," complains Friedrich Rödler, senior partner at PwC, the professional services firm.

His priorities are familiar enough: pensions, health, administration, debt and education. The last of these is particularly important for business, given the need to maintain Austria's traditional strength as a

source of well-educated and well-trained workers for future investors.

But rather than making progress on education, the coalition parties have bickered with each other. The People's party would like to finance university reforms through tuition fees – anathema to the Social Democrats. By contrast, the latter's wish for more mixed-ability secondary schools, rather than Austria's traditional rigorous streaming, is vehemently opposed by the People's party.

"It's about the future of this country. We have to be able to educate our people appropriately," says Mr Rödler.

Frustration with politics forces business leaders to focus on Austria's familiar strengths. Invariably, the well-trained workforce, based on the famous "dual system" of further

education and apprenticeships, features most prominently.

Relative social harmony under the "social partnership" model between employers and unions is the other most frequently mentioned attribute that attracts inward investors, along with the thriving, entrepreneurial *mittelstand* of small and medium-sized companies.

Broadly business-friendly policies at federal, state and local level have also helped, along with flexible labour laws. "The country is doing well because the private sector is doing well," notes Mr Rödler.

Research and development spending, where Austria has traditionally lagged behind some neighbours because of the relative absence of very big companies, has at least improved, if only marginally. Total

R&D spending in 2011 will reach a record of more than €8bn (\$10bn). Nevertheless, Austria still trails counterparts such as Switzerland, Finland or Sweden.

Tax policy remains broadly supportive to business, in spite of threats by the Social Democrats to

budgets has had one unexpected benefit: putting to an end the leapfrogging tax cuts for companies and, to a lesser extent, individuals, that characterised much of central and eastern Europe previously. "The days of competitive tax cuts are over. No one can afford it," says Mr Siegl.

Herta Vanas, partner at Taxand Austria, the tax advisory firm, says small fiscal improvements could still be made. She focuses on agreeing tax deals to encourage wealthy eastern Europeans to relocate to Austria or on giving informal guidance about their potential tax liabilities.

After a sharp decline in 2009, the rate of new companies coming to Austria picked up again as investors recovered and funding became more available after the financial crisis. Investors have also

been encouraged as fears of an economic collapse in parts of central and eastern Europe have eased.

Last year was the Austrian Business Agency's third best in terms of numbers of foreign companies setting up in Austria. As ever, Germany was the most represented, while investment by central and eastern European companies also picked up sharply.

Figures for the first half of this year show a further improvement, with a sharp rise in the number of jobs created. Recently announced arrivals include a European competence centre for Mitsubishi Power Systems Europe and the shift from Munich to Salzburg of BMW's eastern European headquarters.

Admittedly, there have also been some departures: some companies have eliminated one layer of adminis-

tration and moved responsibility for overseeing eastern Europe back to group headquarters, admits Mr Siegl.

As ever, Austria's favourable location as a gateway to central and eastern Europe, its good infrastructure and transport links, and its high quality of life top the list of "soft" attractions.

"Vienna's central location in Europe and as an east-west hub, and the availability of qualified staff convinced us," says Daichiro Ozeki, general manager of Mitsubishi Power Systems Europe, explaining his company's investment move.

"The infrastructure is excellent and all important markets are within two hours' travel. On top of these is the reduced currency risk of being in the eurozone, simplified travel in the Schengen area and, last but not least, the outstanding quality of life."



Herta Vanas of Taxand Austria says small fiscal improvements could be made

unravel some of the reforms introduced over recent years that have helped boost inward investment and raised Vienna's standing as a headquarters for foreign companies, or at least their eastern European operations.

The downturn and deterioration in government

A tale of two tunnel visions on transport

Infrastructure

Well-funded roads ease bottlenecks but rail projects appear too costly, writes Eric Frey

Until this summer driving from Germany and northern Europe to the Mediterranean could be a frustrating experience. Traffic jams were common through the main tunnel on the Tauern autobahn, the Alpine highway that connects the Austrian provinces of Salzburg and Carinthia.

This June, however, a second tube was opened below the crest of the Tauern range, expanding the number of lanes from two to four, and the long delays seem to have disappeared.

The speeding up of the key north-south axis is just one example of the improvements in Austria's road system over the past decade. The previously patchy primary road network is "practically complete", says Sebastian Kummer, transportation and logistics expert at Vienna Business School.

Thanks to a system of road toll stickers for passenger cars and road pricing for trucks, the state-owned motorway operator Asfinag has plenty of resources to pay for maintenance and new construction. In any case, when compared with other western European countries, gridlock on the roads is rare.

Even the long-neglected links to neighbouring countries in

central and eastern Europe have been vastly improved. The highway to the Slovak capital Bratislava, only 40 miles east of Vienna, was completed in 2007, and the new "northern highway" from Vienna to the Czech city Brno is more than halfway to completion.

The main outstanding gap in the road map is a highway from Linz to Prague, but that project is held back by Czech procrastination, Austrian officials say.

In Vienna, the completion of a ring road is deemed too costly and too controversial for ecological reasons because it would have to cross the Lobau national park beside the Danube.

The bigger problems in Austria's infrastructure can be found in the railway network. For years, the state-owned railway company ÖBB invested too little in the maintenance of its lines and rolling stock, causing anger among once-loyal train users.

The cargo business is deep in the red because of falling revenue in the wake of the financial crisis and a misguided acquisition in Hungary. And too many funds are being gobbled up by the construction of expensive new tunnels with questionable economic returns, experts say.

The three large rail projects are the Brenner tunnel between Austria's North Tyrol and Italy's South Tyrol, the Semmering tunnel linking Vienna with Graz, and the Koralm tunnel between Graz and Klagenfurt in the south of the country.

Of the three projects, the Koralm tunnel is the most controversial because neither passenger nor cargo volumes



Capital investment: Vienna's new Central station will speed up journeys but some say it is more about real estate than ease of travel

Getty

but is upgrading the main western rail link between Vienna and Salzburg to allow speeds up to 250km/h.

Meanwhile, from December, the private rail operator Westbahn will compete directly with ÖBB on that key line, which is

expected to result in a better service and lower prices. In general, performance at ÖBB has improved under Christian Kern, its new chief executive, Prof Kummer says.

In Vienna, the construction of the new Central train station on

the site of the former Southern train station will bring important changes for train travellers. Trains departing from the station will be able to go straight from Munich to Budapest without having to change direction at a terminus.

But Prof Kummer believes customers will still prefer to leave from the more centrally located Western train station, which will remain a railhead and will be Westbahn's terminal. "The rationale behind the new central station is real estate development, not transportation," he says. "The station won't solve the railway's problems."

Prof Kummer's favourite project in terms of economic impact is the plan to extend the trans-Siberian railway from the Ukrainian-Slovak border to a terminal east of Vienna. The Russian railway company RZD is pushing for the extension,

which would cost an estimated €6bn and would speed up the transportation of bulk cargo from the Pacific region to central Austria.

"The political will exists, but the open question is: who will finance the rail line through Slovakia?" Prof Kummer says. While the Austrian government favours the project, the centre-right Slovak government is sceptical.

The region between Vienna, Bratislava and western Hungary should also benefit from the construction of a third runway at Vienna airport, which is set to go ahead after most environmental concerns have been addressed. With the long-delayed opening of the new Skylink terminal next year, the airport is expected to ease overcrowding and to reaffirm its position as one of the important east-west hubs in Europe.

Popular attitudes to Brussels have deteriorated from previous lows after Austria's participation in rescue packages for some of the eurozone's southern peripheral members. As in neighbouring Germany, such rescues have fuelled complaints about hard-earned taxpayers' money being "wasted" on spend-thrifts abroad. Mrs Fekter, herself a newcomer to the finance ministry has occasionally contributed to this through occasionally ill-judged remarks.

The popular sense of frustration has been compounded by the lack of any obviously commanding political leaders in the wings – let alone Schüssels in the making. Observers complain regularly that the current political leadership is the least inspiring in decades. And the parties have reduced the roles of the think-tanks and institutes that were once talent pools for the future.

For younger voters especially, looking vainly for bold ideas and big issues, only the Freedom party, or the Greens, offer encouragement, with indifference being the more frequent alternative.

Economy thrives as politics stalls

Continued from Page 1

European Union neighbours, unemployment has fallen below the EU average and inflation, though stoked by rising raw material prices, remains broadly under control. Austria is among the most affluent members of the EU, its quality of life is widely envied, while the capital Vienna is regularly ranked as one of the world's most pleasant cities to live and work in.

Inward investment, though hit understandably during the downturn, has recovered, with foreign companies still regularly choosing Austria for their new facilities or as a regional base for central and eastern European operations.

Yet popular discontent is, if anything, on the rise. Immigration and integration remain fiery political issues, as the far right Freedom party exploits widespread fears about loss of national identity and alleged "Islamisation". So widespread now are such concerns, along with dissatisfaction with the two mainstream coalition parties, that the Freedom party is running virtually neck and neck with the People's party in the opinion polls. Freedom party leader Heinz-Christian Strache has even touted himself as a future chancellor.

However, Mr Strache's periodic attempts to present his group as a party capable of governing have been marred by regular mishaps involving his party colleagues. Such episodes have ranged from corruption allegations in the party's bastion of Carinthia to periodic extremist outbursts elsewhere, leaving Mr Strache struggling to present a consistently more moderate face.

Anti-foreigner feeling extends to the EU, whose image in Austria has suffered from the opening of Europe's eastern borders – in spite of the many economic benefits for business in particular, from new markets and additional workers.

Growth has been restored to a level comfortably above most European Union neighbours

Germany's appetite keeps factories' plates full

Industry

Ed Hammond finds a strong recovery after the dark days of 2008

Austrian manufacturers are benefiting from the rampant march of Germany's industrial sector.

Amid the economic gloom that has lain over the continent for the past three years, factories and workshops from the Ruhr to the Rhine have pushed on. The scale and success of the country's manufacturing base has made Germany's economic growth the envy of the European corporate scene.

As one of its neighbours, Austria has been able to cash in on this growth and the country's own industrial companies are booming.

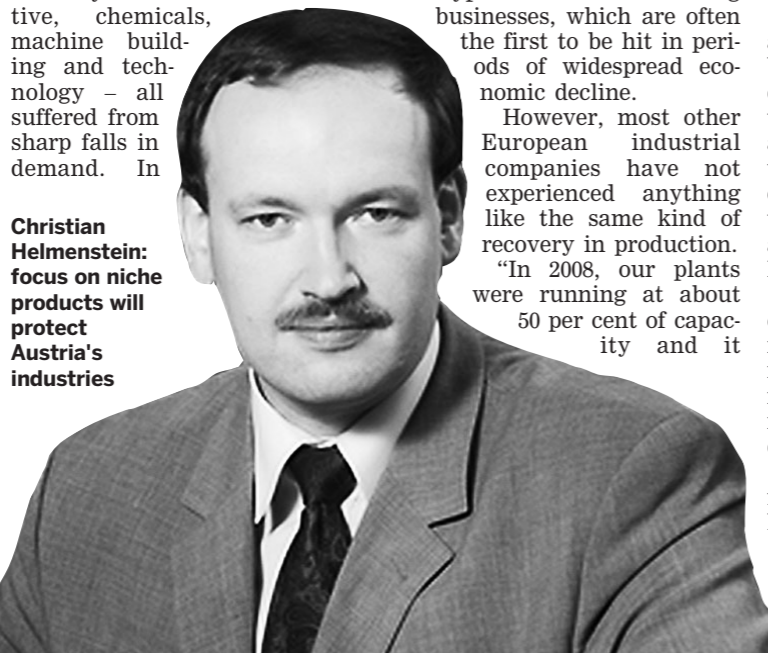
"Our recession depended a lot on how the German companies dealt with the recession they faced," says Christian Helmenstein, economics director for the Federation of Austrian Industries.

Exports across the border account for almost a third of

all Austrian manufacturing output, with a particular focus on feeding into the automotive and chemical industries which form the backbone of Germany's own industrial production.

When Germany cut back on production at the start of the recession in 2008, the four "flagship branches" of Austrian industry – automotive, chemicals, machine building and technology – all suffered from sharp falls in demand. In

Christian Helmenstein: focus on niche products will protect Austria's industries



2009, manufacturing output fell 14 per cent, compared with a gross domestic product decline of 3.9 per cent.

Then, as Germany bounced back, Austrian manufacturing soared 6.9 per cent in 2010 and is forecast to go up 8.5 per cent this year.

These sharp swings in output are typical of manufacturing businesses, which are often the first to be hit in periods of widespread economic decline.

However, most other European industrial companies have not experienced anything like the same kind of recovery in production.

"In 2008, our plants were running at about 50 per cent capacity and it

was a really big slowdown," says Karin Keplinger, a spokeswoman for Voestalpine, the Linz-based steel producer.

Today, Voestalpine's factories are all running at full capacity and the company's confidence about the future is unusually bullish for a business that depends on other countries' industrial appetite.

"The last months – as well as all of 2010 – were characterised by a continuing high level of demand from our most important customer segments, the automobile and commercial vehicle industries, mechanical engineering, the energy industry, railway infrastructure and aviation industry," says Ms Keplinger.

"The indicators from these customer industries have signalled a mostly stable development of demand for the coming months, so we are overall not expecting a sustainable decline."

In spite of its close ties with its neighbour, Austria has few large, multinational companies producing so-called big-ticket goods, such as cars or jet engines.

The country's industrial sector is much more like

Germany's Mittelstand – small to medium-sized companies which tend to manufacture highly specialised products.

Companies such as Wienerberger, the world's largest brick-maker, are typical of the Austrian corporate model.

The company is the dominant force in the global brick market, an unglamorous sector but one that has high barriers to entry and, during a stable economic climate, tends to generate very stable returns.

According to Mr Helmenstein, this focus on delivering niche products, often on a world stage, will protect Austria's position as an industrial economy for many years to come.

"The large European manufacturers are already coming under heavy pressure from Chinese and Indian producers, and this will continue, but the ones that are not producing blockbuster goods will be safer for a long time," he says.

"Ironically, a large conglomerate like Siemens might come under pressure before a producer of a niche product."

One such company is Rosenbauer. As the world's largest maker of fire engines and equipment for firefighters, the com-

pany knows well both the benefits and pitfalls of being at the top of a narrow market.

Unlike most manufacturers, Rosenbauer, which generated sales of €597m last year, depends almost exclusively on public sector spending and, as such, has had to shift its focus away from Europe and look to emerging markets.

"We have just had an order for 80 fire engines from Brazil's airports, so they are ready for the World Cup in 2014. This is typical of the rebalancing we are doing towards the emerging countries," says Gerda Koenigstorfer at Rosenbauer.

The company has two facilities in Germany which have traditionally been used to meet that country's demand for new fire engines. However, with the slowdown in government spending that has become the overriding characteristic of the global economic crisis, Rosenbauer has downsized and started using the plants to export to the Russian market.

"We are able to move to supplying other markets and the demand for new infrastructure in places such as China means that there is plenty of activity for us," Ms Koenigstorfer says.

Doing Business in Austria

A popular system – but does it make sense?

Federalism

Eric Frey weighs the pros and cons of separating spending and taxing powers

With 8m inhabitants, Austria has a smaller population than neighbouring Bavaria, one of Germany's federal states. Austria too is split into Bundesländer – nine in total, each with its own legislature, government and myriad separate rules. The nine provinces range from a population of 1.7m in Vienna, the capital, to 285,000 in Burgenland. But regardless of size, they all have different building codes, different requirements for business start-ups and different laws on youth or animal protection.

While this multitude of rules increases red tape for some businesses, the main burden lies on public finances. The system of federalism results in large and duplicate bureaucracies that boost government spending without providing real benefits to the economy or citizens.

A reform of federalism has been at the top of every government agenda for decades and has gained new urgency through the sharp increase in public deficits and debt burdens following the financial crisis. But changes have been made in only a few areas, and in the face of strong opposition from provincial leaders, who fiercely defend the current system.

And the current coalition government of Social Democrats and conservatives (the Volkspartei) does not even try, critics say. "There is no movement here at all," says the former steel manager Claus Raidl, president of the Austrian national bank.

The Austrian chamber of commerce estimates that removing waste and over-

laps in the health system, school administration and bureaucracy could save €5bn (\$6.8bn) a year, which is about half the country's current fiscal deficit.

While some economists say such savings are too optimistic, they still feel significant gains could be made from reforms.

The key problem in Austria is the separation of spending and taxing powers. The Länder receive their funds from the federal government through an elaborate system of fiscal transfers, but can decide on key issues, such as the building of hospitals and the hiring of teachers.

While the federal government eliminated the privileged pension system for its own employees, several provinces still pay lavish pensions to their retired officials. This structure fosters waste but does not create real regional diversity, because the same federal rules apply everywhere. Most of the provincial officials are bound to execute decisions made by the central government.

Any changes have been opposed by provincial leaders, who fiercely defend the current system

"The Länder play a major administrative role but have far less say over legislation than in Germany or Switzerland," says Franz Fallend, a political scientist at the University of Salzburg. "The system is popular, but nobody asks the question: 'Does it actually make sense?'"

Mr Fallend would like to see power over tax rates transferred to the provinces, an idea that was recently picked up by Maria Fekter, finance minister. She proposed to let the Länder set different rates of property taxes, which are currently uniformly low. But that idea was also



Vienna mayor Michael Häupl: a key political power broker in the country

Reuters

rejected by most governors, who would prefer to see the current fiscal transfer system extended.

The nine provincial parliaments have few areas where they can make a difference. In contrast, most of the governors play influential roles in their respective parties.

The main power brokers are Michael Häupl, the Social Democratic mayor of Vienna, and Erwin Pröll, the conservative governor of Lower Austria (Niederösterreich). Both chancellor Werner Faymann, the Social Democratic leader, and his conservative counterpart Michael Spindlberger, the foreign minister and vice-chancellor, are widely believed to owe their jobs to their respective mentors.

"The current set-up does not lend itself to significant reforms," says Mr Fallend. "Perhaps things will change after Mr Häupl and Mr Pröll have left the political scene."

The most wasteful part of the federal system is the health service. While experts call for a sharp reduction in the number of hospital beds and recommend the closing of several smaller clinics, the Länder are building new ones.

In some places, two hospitals that are only a few miles apart will offer the same kind of services because they lie in different

provinces and will not even make a meaningful effort to co-operate. The operating costs are carried by the national health insurance system, which is forced to reimburse the hospitals for every patient service.

As a consequence, health spending in Austria is equivalent to 11 per cent of gross domestic product, which is well above the average of 9.5 per cent for all countries in the Organisation for Economic Co-operation and Development,

while the quality of health services is often mediocre.

Opinion polls show that Austrians support a reform of federalism in principle but tend to oppose any specific measure, such as the closing of administrative offices or court houses in smaller towns.

When a maverick provincial politician suggested in the 1990s that the nine Länder should be merged into three, he was attacked from all sides and never raised the issue again.

A good climate for growth

Case study Vorarlberg

Haig Simonian meets the deputy premier of Austria's westernmost state

In Austria, the crucial instruments for economic development, such as tax, lie with the federal government. But the success of Vorarlberg, the westernmost state on the borders of Switzerland, Germany and Liechtenstein, shows the regions can play a part.

Since the 1970s, Vorarlberg has changed from being 70 per cent dependent on textiles into an economically balanced and flourishing region of predominantly small and medium-sized companies, largely family owned and often focused on high technology.

Officials acknowledge Vorarlberg's development has benefited from its handy geographic position in the Rhine valley crossroads between traditional north-south and east-west trading routes. Proximity to big export markets, notably Germany and Italy, has also helped.

But Markus Wallner, Vorarlberg's young deputy premier, argues state policies have reinforced the climate for entrepreneurship and investment in Austria's second smallest region by size and population.

"We have invested heavily in education,

training and incentives for research and development," says the 44-year-old at his office in the state parliament in Bregenz, Vorarlberg's picture postcard capital on Lake Constance.

Widely tipped as successor to Herbert Sausgruber, Vorarlberg's veteran premier, Mr Wallner looks after building and health, along with aspects of social policy, in the seven-member government.

Best known for its lake and high mountains, the state is home to a handful of big companies, such as Zumtobel in lighting, Doppelmayr, a top ski-lift maker, and Wolford, a



Investments in education and R&D incentives have paid off, says Wallner

byword for tight. But it is mainly a patchwork of smaller groups, often technological leaders, and all highly export orientated.

"The local economy is now very broadly based, and that's definitely helped us get through tougher times," says Mr Wallner.

The data demonstrate the state's relative success. While the economic downturn, notably in Germany, prompted job losses, the pendulum has now swung the other way. "All Austria's states are strongly export orientated. But we are particularly so," says Mr Wallner.

At 4.8 per cent under the

Austrian measure at the end of July – down 1 percentage point compared with the previous year – Vorarlberg's jobless rate was well below the national average. Likewise this year's 3.2 per cent forecast for economic growth should be about 0.4 percentage points above the national average.

Economic growth has been assisted by harmonious labour relations. Vorarlberg, along with like the rest of Austria, stresses the "social partnership" of employers and workers, with an emphasis on consensus.

Similarly in politics, although a bastion of the conservative Austrian People's party since the war (it has had an almost uninterrupted absolute majority) the party has, under a local convention, invariably invited another group in to share power.

The biggest challenge to the upbeat economic picture is the need to maintain a skilled workforce. That could become particularly tricky given local sensitivities to immigration. About 15 per cent of the population is already foreign, second only to Vienna; this makes immigration a convenient platform for the anti-immigrant far right Freedom party – Vorarlberg's second biggest political group.

"We... realise integration is an issue," says Mr Wallner. "But providing qualified workers – especially in specific areas – will always be the biggest challenge for us."



cee stock exchange group

The largest player in the CEE region



jointforces

Red Bull Where marketing goes into overdrive

Visitors to Red Bull's Austrian headquarters are liable to get lost.

The verges of the narrow road winding into the hills east of Salzburg bear no signposts. Miles of unbroken meadow and yellowing thickets pass without a hint of the silver and blue insignia that wraps itself round the company's eponymous energy drinks. Even when I arrive at the volcano-shaped building that houses Red Bull's 350 head office staff, there are no obvious indicators to back up the satnav's monotone insistence that we have "reached our destination".

Until I walk in and see a Formula One racing car parked in the atrium, it is hard to be certain I'm at the right place. For a brand that has flourished on having a highly visible marketing strategy, this seems odd.

Not so, says the lady showing me round the headquarters. She says the absence of signposts is deliberate, so that when people think about Red Bull it is about the athletes and the events, not the offices.

This accords with the philosophy woven into Red Bull by Dietrich Mateschitz, who co-founded it in 1984 and remains its largest shareholder.

"Our media philosophy is as simple as it is correct: the onus is on the media to create content, not on us to provide it. If our results, achievements and activities are worth reporting, you will read about them," he says.

"We disagree with the philosophy of many others who abuse the media for personal gain. Imagine if you removed everything from the papers that was announced but never came to fruition or took place or that later proved to be inaccurate."

For the most part, the group has done well at providing the media with activities to report on. So much so, in fact, that when people say Red Bull, it is hard to know if they are referring to the drink, the world championship-winning F1 team, the company's spectacularly dangerous-looking air-racing series, or the rash of other extreme sports events to which it lends its name.

In spite of the energy invested in its marketing campaign, Mr Mateschitz says the quality of the drink is still the most important factor in Red Bull's success.

"The best marketing strategy and the highest marketing budget in the world cannot win back a disappointed consumer. Long-term success is based on product quality and repurchase rate," he explains.

The inspiration to launch the company came to Mr Mateschitz during his tenure as international marketing director for Blendax, a toothpaste maker now owned by Procter & Gamble. Travelling in Thailand, he quickly saw a gap in the European market for a

modified version of energy drinks widely consumed in the country.

In the 27 years since then, Red Bull's association with adrenalin-fuelled sports has created a wave of brand goodwill that has helped it become the world's most consumed energy drink, selling more than 4bn cans last year, and one of Austria's biggest corporate success stories. This global reach also means it has, so far at least, weathered the fall in consumer spending in western economies.

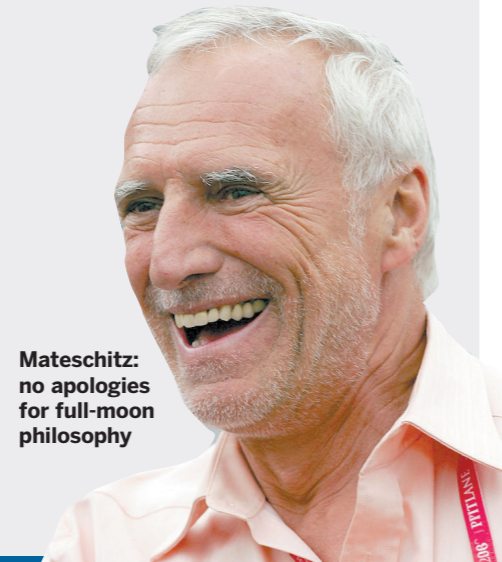
During 2010, the privately held company saw sales in Brazil grow by 32 per cent, while Turkish and Japanese consumers increased their intake by more than 80 per cent. Overall, the group posted sales last year of €3.78bn (\$5.17bn), compared with €3.26bn a year earlier.

In spite of its size, however, the group is still steeped in the sort of folklore and philosophical quackery that most large multinationals eschew in favour of efficiency of production. In one example of the group's unusual approach to mass production, the caps on its bottled mineral water can be sealed only on nights when the moon is full in the sky.

This is the kind of behaviour that could infuriate shareholders of a publicly listed company. Mr Mateschitz is unambiguous about the likelihood of Red Bull appearing on the stock market in the future, however.

"Never. Thanks to our financial philosophy, we are not and never have been in need of additional capital, nor does anybody want to cash in. If we were to go public, the company would lose all of its benefits and in turn we would be left with numerous disadvantages," he says.

Ed Hammond



Mateschitz: no apologies for full-moon philosophy

The Vienna Stock Exchange initiated the CEE Stock Exchange Group (CEESEG), which consists of the four stock exchanges of Budapest, Ljubljana, Prague and Vienna. The CEE Stock Exchange Group is the largest group of exchanges in the region.

Its goal is to strengthen and advance the regional capital markets of Austria, the Czech Republic, Hungary, and Slovenia. This yields many benefits for issuers, trading members, institutional investors as well as data vendors and index license customers of all member exchanges.

For further information please visit www.ceeseg.com

wienerborse.at