AUSTRIAN STABILITY PROGRAMME

Update for the period 2001 to 2005

Federal Ministry of Finance

Vienna, 27 November 2001

FEDERAL MINISTRY
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Texteingabe

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1. Introduction and summary

In accordance with Regulation (EC) No 1466/97, each Member State is required to submit a stability programme or a convergence programme . Austria herewith submits its updated stability programme for the period 2001 to 2005. The programme's new structure reflects the agreements reached by the Ecofin Council on 10 July 2001.

Since the previous stability programme, the economic environment has become more difficult. Viewed over the short term, cyclical risks are greater than in previous years. At the same time, however, there is no reason to assume that Austria and Europe cannot return to their potential growth path before too long .

In 2001 the government deficit has been brought into balance. This target will be maintained in 2002 and 2003, after which, on unchanged policies, the cyclical upswing predicted on the back of the structural reforms carried out will produce modest surpluses. The general government debt ratio is on a clear downward path and should fall to the reference value of 60% of GDP in 2002.

Assuming an unchanged legal situation, long-term forecasts point to a marked increase in expenditure on pension and health provision. Working groups were set up with the task of submitting appropriate proposals for ensuring the sustainability of the systems.

The update of the stability programme has been drawn up on the basis of the most recent economic assessment, the measures adopted in 2000 and 2001 for implementing the government programme, the measures in the Federal budget for 2002, the fiscal burden sharing arrangements and the domestic stability pact agreed with the provinces and municipalities. In particular, the Federal Government has set itself the following economic-policy priorities:

- to achieve a balanced government budget over the economic cycle;
- to make Austria more attractive as a business location by improving the conditions for growth;
- to combat unemployment unremittingly;
- to revamp social-protection systems and to safeguard pensions and retirement provision;
- to reform government tasks and public services;
- to dispose of the Federal Government's shares in firms.

In order to safeguard the robustness of the budget scenarios, the economic forecasts underlying the stability programme are again cautious, in line with Austrian practice.

This programme may be consulted on the website of the Austrian Federal Ministry of Finance: http://www.bmf.gv.at.

2. Austria's economy in the period 2001 to 2005

2.1. Slowdown in economic growth in 2001

The behaviour of domestic demand and employment was less favourable in 2001 than had been expected when the previous stability programme was drawn up in December 2000. Economic growth in Austria slackened throughout the year in line with developments in the European Union (Figure 1). Real economic growth was underpinned by private consumption, whereas export demand and investment, particularly in building and construction, dipped sharply. There are still no clear empirical indicators of the possible depth of the current cyclical downswing. Assuming growth of 1.1% and 0.6% for the third and fourth quarters respectively, we obtain (on the basis of the current figures for the first and second quarters) annual real GDP growth of 1.3%.

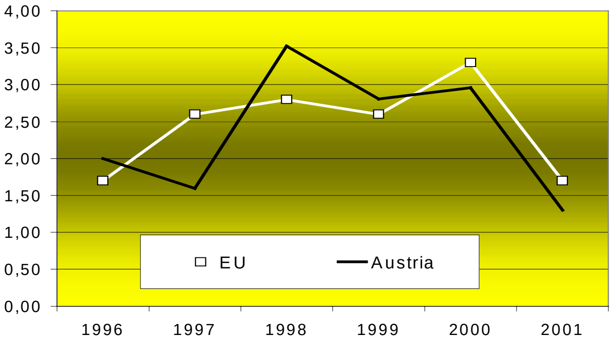
The rate of growth in employment declined until October 2001 (0.35% up on the previous year). Female employment has risen year-on-year since December 1996 (October 2001: +1.6%), whereas male employment has contracted year-on-year since July 2000 (October: -0.5%). The unemployment rate fell in the early part of the year, but rose from May onwards to 3.9% in October 2001 (Figure 4). Unemployment has risen particularly in the construction sector, among young people and among the over-60s.

Since the beginning of 2000 the inflation rate has moved roughly in line with the EU average. Energy and meat prices, together with their indirect downstream effects, meant that the increase remained at the unexpectedly high level of over 2½%. The rise in inflation, however, probably peaked in May and July 2001.

Long-term nominal interest rates in the euro zone fluctuated between 4.5% and 5% in the course of the year before falling sharply in October/November and approaching in mid-November the very low rates recorded last in 1999. In Austria the interest rate differential with the German Bund benchmark narrowed to just under 25 basis points (Figure 2). At the short end, the European Central Bank lowered interest rates in several stages and particularly after the events of 11 September 2001, and this again caused the yield curve to steepen. The euro exchange rate against the US dollar so far fluctuated this year (Figure 6). Overall, it may be said that in the first three quarters European monetary policy probably had a neutral to slightly restrictive effect in Austria. The interest rate reduction announced by the ECB on 8 November, coupled with the resulting fall in lending rates, probably had a neutral to slightly positive cyclical effect.

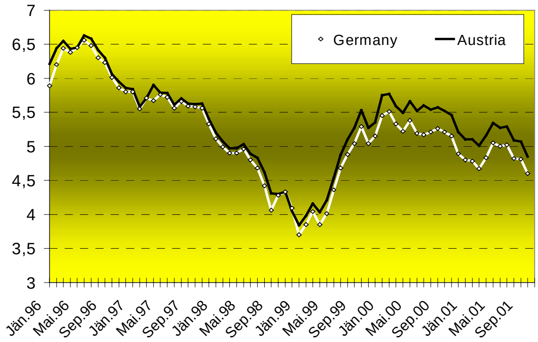
The current-account deficit remained high at a (forecast) 2.6% of GDP (Figure 5). According to a provisional cash-based calculation, the current-account balance improved by some €0.6 billion or 0.3% of GDP in the first nine months of 2001 compared with 2000. A two-digit percentage increase was still recorded in incoming and outgoing payments. A more favourable balance on services and lower transfers abroad are the main reasons for the improvement.

Figure 1: Real economic growth in Austria and in the EU, 1996 to 2001



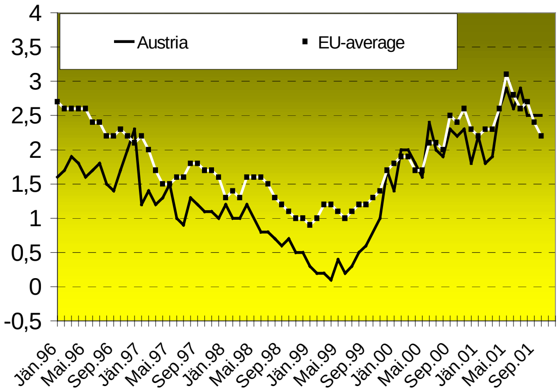
Sources: Statistik Austria, Federal Ministry of Finance, EU Commission

Figure 2: Long-term interest rates (%) in Austria and Germany, 1996 to 2001



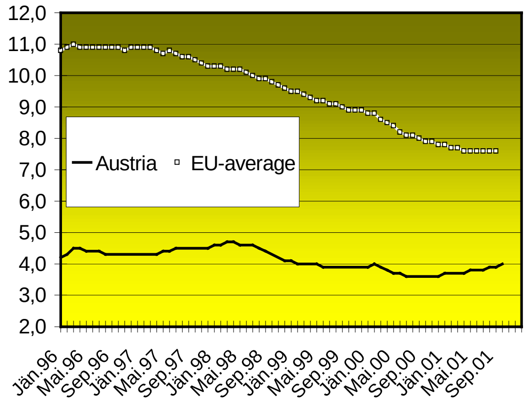
Sources: Austrian National Bank

Figure 3: Harmonised consumer prices in Austria and EU average, 1996 to 2001



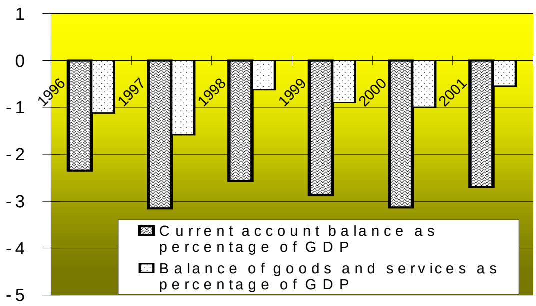
Source: EUROSTAT

Figure 4: Unemployment in Austria compared with EU average, 1996 to 2001



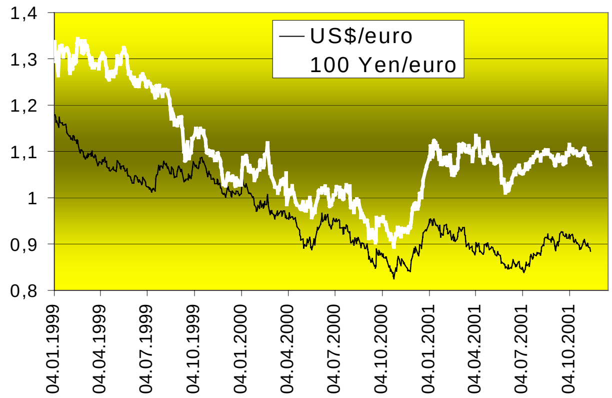
Source: European Commission, Labour Market Service (AMS)

Figure 5: Current account balance as percentage of gross domestic product, 1996 to 2001



Sources: Statistik Austria, Austrian National Bank, Austrian Economic Research Institute (WIFO), October 2001

Figure 6: US$/€, 100 YEN/€ exchange rates from 1999



Source: European Central Bank

2.2. Economic developments in the period 2002 to 2005

Europe is currently in a phase of economic slowdown whose depth, duration and regional distribution are difficult to ascertain on account of the tragic events of 11 September 2001 in the United States. International institutions such as the OECD and the International Monetary Fund as well as the European Commission, but also the Austrian Economic Research Institute (WIFO) paint a somber picture of short-term prospects. The slowdown is attributable to lower business investment and slower growth in world trade. As things stand, it is unclear to what extent these developments will affect consumer confidence and thus dampen consumer demand. In the medium term, however, there is no reason to assume that Europe could not revert to its normal growth path since, unlike during earlier periods of decelerating growth, there are no serious macroeconomic imbalances within the euro zone that would have to be rectified. Commodity prices, including oil prices, have fallen during the year 2001. It is reasonable to assume that they will continue to track growth and that there is at the moment little likelihood of a negative price shock.

In line with Article 105 of the EC Treaty, monetary policy in the euro zone is aimed at achieving price stability. It is assumed in the present programme that the inflation rate in the euro zone will average just under 2% a year from 2003 onwards. In the wake of the terrorist attacks in the United States, an pronounced expansionary stance has been imparted to monetary policy there. The ESCB is moving somewhat slower, because the inflation rate in particular carries much stronger weight in monetary policy. Long-term interest rates in the euro zone, which had fallen well below 4.5% in November 2001, could remain below 5% also in the medium term before picking up again towards the end of the forecasting period as the economy picks up (see Table 1). Market expectations at the moment are that the US dollar will lose little ground against the euro.

For Austria, it is assumed that the social partners will continue to take account of the external environment in their wage and incomes policy. In view of expected economic developments, the impact of labour costs on the inflation rate is expected to remain modest. Public budgets will have no direct price effects from 2002 onwards. Structural reforms should continue to hold down inflation. Overall, the inflationary picture will probably be much the same as in the euro zone.

The forecast (standard scenario) used for the stability programme assumes that, following the hiatus in growth in 2001/02, the Austrian economy will pick up. Since growth has weakened sharply during 2001, this also implies a negative "carry-over" for growth rates in 2002. And so, even if growth speeds up in the second half of 2002, the average annual growth rate will be only slightly higher. Private consumption growth is traditionally very stable. In early 2001 it was again underpinned by rising employment. The initial results of the 2002 wage round point to wage increases of around 3% per capita, which could push up the wage ratio slightly – in line with established conjunctural patterns - and would likewise underpin consumption expenditure. Corporate investment is expected to rebound only from 2003 onwards. The public sector will not exert a restrictive influence. The risks attached to this forecast are mostly downward in the short term and upward in the medium term. They will be influenced in particular by international developments.

Table 1: Economic trends, 1999 to 2005 (percentage change on previous year)

	ESA code	1999	2000	2001	2002	2003	2004	2005
GDP growth at constant market prices	B1g	2,8	3,0	1,3	1,3	2,4	2,8	2,8
GDP level in bn Euro*	B1g	196,7	204,8	210,5	217,8	226,7	236,3	246,5
GDP deflator		0,7	1,2	1,4	2,1	1,6	1,5	1,5
Private consumtion deflator		0,7	1,5	2,6	1,8	1,8	1,8	1,9
HICP change		0,5	2,0	2,5	1,8	1,8	1,8	1,9
Dependent employment		1,0	1,2	0,4	0,0	0,8	0,8	0,8
Labour productivity growth**		1,9	2,0	0,9	1,2	1,7	2,1	2,0
Wages/head		2,8	2,3	3,1	3,1	2,9	3,2	3,1
Unit labour costs		1,3	1,2	2,3	1,9	1,2	1,1	1,1
Unemployment rate		4,5	3,7	3,9	4,1	4,0	3,8	3,7
Current account balance as a % of GDP		-2,5	-2,8	-2,6	-2,5	-2,5	-2,4	-2,3
Sources of growth: percentage changes at constant prices								
1. Private consumption expenditure	P3	2,8	2,5	1,6	1,5	1,5	1,7	1,6
2. Government consumption expenditure	P3	2,2	0,9	0,8	0,8	0,5	1,0	1,0
3. Gross fixed capital formation	P51	1,5	5,1	-0,3	-0,3	3,6	4,3	4,5
4. Changes in inventories and net acquisition of	P52+P53	1,0	0,7	0,5	0,4	0,3	0,3	0,4
5. Exports of goods and services	P6	8,7	12,2	5,5	3,8	5,9	6,5	6,4
6. Imports of goods and services	P7	8,8	11,1	4,6	3,0	4,7	5,5	5,7
Contribution to GDP growth								
7. Final domestic demand (1+2+3)		2,3	2,8	1,0	0,9	1,8	2,1	2,1
8. Change in inventories (=4)	P52+P53	0,5	-0,3	-0,2	-0,1	-0,1	0,0	0,1
9. External balance of goods and services (5-6)	B11	0,0	0,5	0,5	0,5	0,7	0,7	0,6
Basic assumptions								
Short-term interest rate		3,0	4,4	4,3	3,0	3,5	4,0	4,0
Long-term interest rate		4,6	5,6	5,1	4,8	5,0	5,3	5,4
US-$/Euro exchange rate		1,066	0,922	0,900	0,917	0,930	0,930	0,930
USA GDP growth, volume		4,1	4,2	1,0	0,7	2,8	3,2	3,0
Euro-zone GDP growth, volume		2,7	3,4	1,6	1,3	2,4	2,8	2,8
Oil prices in US-$/barrel		17,3	28,0	24,6	21,7	22,3	23,0	23,7

*Schilling entry-rate of 13,7603 Schilling/Euro

**GDP-growth/employed

Sources: Austria; Federal Ministry of Finance.

3. Economic policy up to 2005

3.1. Budgetary policy and medium-term objective for the budget balance

The aim of Austrian economic policy is to make a positive contribution to a stable and balanced economic development in Austria, the European Union and the euro zone. Austria is thus committed to adhering to the stability and growth pact. For budgetary policy, the obligation under Article 104 of the EC Treaty applies, namely that the general government deficit may not exceed 3% of GDP. After wide-ranging discussions, the

Federal Government and the lower levels of government agreed in September 2000 to reduce the government deficit sustainably to zero over the economic cycle. The necessary measures were spelt out in detail in the December 2000 domestic stability programme. The core of the budgetary policy strategy comprises:

- expenditure savings in public budgets underpinned by structural reforms;
- increases in revenue in line with a broadening of tax bases;
- structural reforms of the product, labour and capital markets;
- privatisation of public assets.

The life of the present parliament comes to an end in 2003. Assuming that the next government adheres to the current budgetary policy strategy, and on the basis of forecast cyclical developments and declining interest payments, modest budgetary surpluses will be achieved towards the end of the forecasting horizon.

Table 2: Cyclical developments and budget balances, 1999 to 2005

% of GDP	ESA Code	1999	2000	2001	2002	2003	2004	2005
1. GDP growth at constant prices	B1g	2,8	3,0	1,3	1,3	2,4	2,8	2,8
2. Actual balance	B9	-2,2	-1,1	0,0	0,0	0,0	0,2	0,5
3. Interest payments	D41	3,5	3,5	3,4	3,3	3,1	3,0	2,8
4. Potential GDP growth*		2,3	2,3	2,2	2,2	2,2	2,3	2,3
5. Output gap		0,4	1,1	0,2	-0,7	-0,6	-0,1	0,4
6. Cyclical budgetary component		0,1	0,3	0,0	-0,2	-0,2	0,0	0,1
7. Cyclically-adjusted balance		-2,3	-1,5	0,0	0,2	0,2	0,2	0,4
8. Cyclically-adjusted primary balance		1,2	2,2	3,1	3,4	3,2	3,2	3,2
*HP-filter method								

NB: Rounding differences are possible.

Sources: Statistik Austria; Federal Ministry of Finance.

In order to analyse the medium-term sustainability of budgetary policy, the European Commission applies the concept of potential output, which is intended to measure a country's economic performance in the absence of inflationary strains. By comparing actual gross domestic product and potential output, an "output gap" can be calculated. Using econometric techniques, it can be calculated how the budget balance reacts to changes in the output gap. A cyclically adjusted budget balance can thus be calculated that depicts the budget balance under normal cyclical conditions. There are various techniques, each with its own advantages and disadvantages, that can be used to calculate potential output, which cannot be directly observed. Econometrically, the calculation of budget elasticities is no easy undertaking either since, for example, a great deal of data suffers from so-called structural breaks and budget elasticity is not determined solely by developments in real GDP (see also Chapter 4). The cyclically adjusted budget balance is probably accurate to +/-¼ percentage point of GDP.

3.2. Public budgets in 2001

The Federal Government's budget implementation for 2001 has developed much more favourably than expected. It can be assumed that the administrative deficit will total some €1.45 billion (ATS 20 billion); a deficit of €2.38 billion (ATS 32.8 billion) was budgeted. On the expenditure side, savings were made in interest payments and as a result of the administrative reforms (see the stability programme of 19 December 2000). This improvement, however, is also due to the development of tax payments, which, after deducting the shares going to the provinces and the municipalities, are expected to be

€0.94 billion (ATS 13 billion) higher than in the preliminary budget. Using the ESA definition, the Federal Government's public deficit is similarly expected to amount to €1.45 billion (ATS 20 billion). Together with the surpluses of the provinces, a balanced budget, i.e. a "zero deficit", will likely be achieved as early as 2001.

As a result of the more sluggish economic performance, revenue from turnover tax and wage tax is below what was budgeted. The main positive developments as regards tax revenue concern income tax and corporate tax. This additional revenue cannot be explained by the current economic situation. Rather, the measures taken in connection with the 2001 consolidation package have a much stronger impact than originally expected. Above all, the recently introduced interest payment on tax arrears generated receipts that were €0.94 billion (ATS 13 billion) higher than expected.

The slowdown in economic activity was also reflected in the Federal subsidy to the public pension funds, though, which exceeded initial expectations as a result of the lower level of contributions, as well as in the unemployment programmes, for which significantly more funds are needed than budgeted because of the rise in unemployment.

Expenditure on employees, one of the largest items on the expenditure side, is lower than budgeted. Restitution payments of some €0.23 billion (ATS 3.2 billion) are to be made this year under an authorisation in the preliminary budget. Expenditure on civil servants' pensions is also over budget owing to the unexpectedly high number of people taking retirement. Developments indicate that possibly retirements are being brought forward from future years. For this reason, the large number of retirements is being used for savings in civil service posts. These additional expenditures are being offset by strict budget implementation on the administrative front. Discretionary spending was reduced by €0.21 billion (ATS 3 billion). Interest payments are significantly lower than estimated. In addition, the budget will also benefit in 2001 from the higher dividends payable by the Austrian National Bank and the fact that the contribution to the EU budget will be lower than budgeted.

The privatisation programme continued (see Chapter 7). Proceeds were used to repay the debts of the Austrian Industrial Holding Company (ÖIAG).

The public debt ratio stood at 63.5% of GDP at the end of 2000. The Federal debt burden in yen amounted to €8.92 billion (ATS 122.8 billion) while that denominated in Swiss francs totalled €7.83 billion (ATS 107.8 billion). During 2001 the provincial authorities sold loans with a nominal value of some €5.8 billion (ATS 80 billion). These will be used in part to enhance the financial assets of the public sector or for debt redemption purposes, thereby easing the public debt ratio, which should be below 62% of GDP by the end of the year.

3.3. The federal budget for 2002

The federal budget for 2002 was adopted by parliament already in the spring of 2001. The key measures as compared with 2001 were already described in the stability programme for 2001 dated 19 December 2000 and are being implemented as planned. To take account of the changed economic situation, which impacts on the labour market and pension insurance, the budget for 2002 was amended in autumn this year. The main changes relate to the resources for unemployment insurance (+€0.3 billion) and for statutory pension insurance (+€0.24 billion). These spending increases are being offset above all by lower interest payments, increased revenue from the dividends paid by the Austrian National Bank and by a reallocation of resources. Estimated expenditure for 2002 is now €59.37 billion while revenue is expected to total €58.54 billion, yielding an anticipated deficit of €0.83 billion. The Maastricht deficit for the Federal Government sector is around €1.6 billion (some 0.7% of GDP) for 2002. Allowing for the surpluses which the provincial authorities have pledged to achieve, there should be a balanced general government budget in 2002 also.

3.4. Provinces and local authorities

On 16 October 2000 the Federal Government, the provinces and the local authorities agreed the revenue sharing arrangements (*Finanzausgleich*, or FAG) for the period up to 2004 and a pact on the joint achievement of the deficit target of 0% of GDP in 2002 (see the stability programme of 19 December 2000). Implementation of the agreements is essentially going according to plan.

- In October 2001 the Federal Government and the provinces agreed on task and structural reforms.
- The agreed pupil/teacher ratios are being implemented at provincial level.
- The system of housing assistance was reformed and extended to include measures to maintain or improve the infrastructure and measures to achieve the Kyoto objective.
- A penalty system reflecting corresponding arrangements at European level was set up. The decision on the new information system to support the amended stability pact will be taken shortly.

3.5. Public budgets from 2002 to 2005

Table 3 shows developments in the individual expenditure and revenue categories under the standard scenario. Expenditure as a share of GDP will fall by 4 percentage points between 1999 and 2005.[1] Public revenue will also fall by 1.3 percentage points. The government budget balance will thus improve by 2.7 percentage points in 2005 compared with 1999.

On the expenditure side, the reforms affecting public services (see Chapter 5) will lead to permanent savings, with the expenditure dynamics thus failing to keep pace with nominal GDP growth. Monetary social welfare payments will be held down particularly as a result of the pension reform and, from 2003, as a result of the fall in unemployment. Savings on interest payments will be achieved as the debt ratio falls. Subsidy payments should expand less rapidly than GDP.

[1] No additional fiscal policy measures are assumed.

Table 3: Budgetary developments, 1999 to 2005

% of GDP	ESA code	1999	2000	2001	2002	2003	2004	2005
Net lending (B9) by sub-sectors								
1. General government	S13	-2.2	-1.1	0.0	0.0	0.0	0.2	0.5
2. Central government	S1311	-2.5	-1.4	-0.7	-0.7	-0.7	-0.5	-
3. State government (excl. Vienna)	S1312	0.3	0.2	0.6	0.6	0.6	0.6	-
4. Local government (incl. Vienna)	S1313	0.1	0.1	0.1	0.1	0.1	0.1	-
5. Social security funds	S1314	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
General government (S13)								
6. Total receipts	ESA	51.6	51.1	52.6	51.5	50.8	50.4	50.3
7. Total expenditures	ESA	53.8	52.2	52.6	51.5	50.8	50.3	49.8
8. Budget balance (6-7)	B9	-2.2	-1.1	0.0	0.0	0.0	0.2	0.5
9. Net interest payments	D41	3.5	3.5	3.4	3.3	3.1	3.0	2.8
10. Primary balance (9+8)		1.4	2.4	3.4	3.3	3.1	3.1	3.3
Components of revenues*								
11. Taxes	D2+D5	28.5	28.1	29.8	29.2	28.7	28.5	28.5
12. Social contributions	D61	17.2	17.2	17.2	17.1	17.0	17.0	17.0
13. Other		6.0	5.8	5.6	5.3	5.1	4.9	4.8
14. Total receipts	ESA	51.6	51.1	52.6	51.5	50.8	50.4	50.3
Components of expenditures*								
15. Collective consumption	P32	17.6	17.3	17.1	16.8	16.6	16.4	16.3
16. Social transfers in kind	P31	4.7	4.7	4.6	4.6	4.5	4.5	4.4
17. Social transfers other than in kind	D62	18.8	18.8	18.9	18.9	18.7	18.6	18.6
18. Interest payments	D41	3.5	3.5	3.4	3.3	3.1	3.0	2.8
19. Subsidies	D3	2.6	2.6	2.7	2.3	2.4	2.4	2.4
20. Gross fixed capital formation	P51	1.8	1.7	1.6	1.6	1.6	1.6	1.6
21. Other		4.8	3.7	4.2	3.9	4.0	3.9	3.8
22. Total expenditures	ESA	53.8	52.2	52.6	51.5	50.8	50.3	49.8

*There are rounding differences.
NB. The Austrian stability pact allows the public authorities to diverge temporarily from the figures agreed.
In 2000 the UMTS licensing receipts and other one-off receipts lowered the expenditure ratio by 0.7 percentage point according to the ESA.
Sources: Statistik Austria, Federal Ministry of Finance.

The share of public investment in GDP should remain more or less constant. It should be noted that a large number of infrastructure investments are no longer recorded in the public budgets.

In the standard scenario, given the foreseeable trend in the deficit, the level of public debt remains on a clear downward trend (cf. Table 4). The macroeconomic environment and the primary balance are sufficient to offset the still high interest-rate effect and to keep the debt ratio on a downward trend. The level of public debt should fall below the reference figure of 60% in 2002.

Table 4: Trend in public debt

	ESA Code	1999	2000	2001	2002	2003	2004	2005
Government debt in € bn		127.5	130.0	130.0	129.7	129.6	129.4	128.3
As % of GDP								
Government debt ratio		64.9	63.5	61.8	59.6	57.2	54.7	52.1
Change in government debt ratio		0.9	-1.4	-1.6	-2.3	-2.4	-2.4	-2.7
Contribution to change in debt ratio								
Primary balance	B9	-1.4	-2.4	-3.4	-3.3	-3.1	-3.1	-3.3
Public-sector interest payments	D41	3.5	3.5	3.4	3.3	3.1	3.0	2.8
Nominal GDP growth	B1g	-2.2	-2.6	-1.7	-2.1	-2.3	-2.3	-2.3
Stock-flow adjustment[1]		1.0	0.1	0.0	-0.2	-0.1	0.1	0.1
Implied interest rate on government debt		5.7	5.6	5.5	5.5	5.4	5.4	5.4

1) Residual variable.
Source: Federal Ministry of Finance.

4. Sensitivity analysis and comparison with previous stability programmes

Table 5 compares current data with those in the update of 19 December 2000. The initial values given for 2000 were revised. While the GDP figure was lower, the budget balance showed an improvement. The downward revision to the growth scenario increases the debt ratio.

Table 5: Economic growth and net borrowing by the public sector between 2001 and 2005; comparison with the stability programme for 2001

	ESA Code	1999	2000	2001	2002	2003	2004	2005
GDP growth, real	B1g							
Stability programme 2001		2.8	3.5	2.8	2.7	2.3	2.5	
Stability programme 2002		2.8	3.0	1.3	1.3	2.4	2.8	2.8
Difference		0.0	-0.5	-1.6	-1.4	0.1	0.3	-
Actual budget balance	B9							
Stability programme 2001		-2.1	-1.4	-0.7	0.0	0.0	0.0	
Stability programme 2002		-2.2	-1.1	0.0	0.0	0.0	0.2	0.5
Difference*		0.0	0.2	0.7	0.0	0.0	0.1	-
Government debt ratio								
Stability programme 2001		64.6	63.1	61.4	59.1	57.2	55.3	
Stability programme 2002		64.9	63.5	61.8	59.6	57.2	54.7	52.1
Difference**		0.2	0.4	0.4	0.4	0.0	-0.6	-

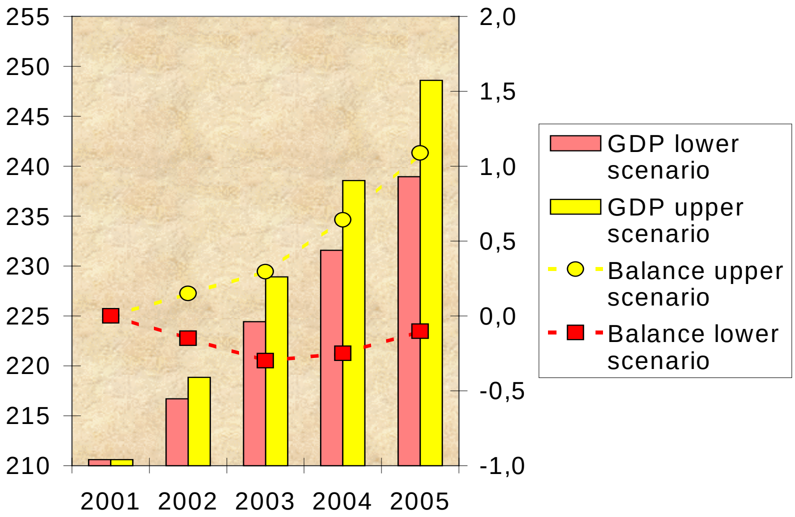
* A positive sign denotes an improvement.
** A positive sign denotes a deterioration
Rounding differences are possible.
Source: Federal Ministry of Finance.

. The main reasons for the improvement in public finances that has taken place despite the more unfavourable real economic developments in 2001 are the following:

- The government deficit and nominal GDP in 2000 were revised downwards, affecting the sustainable revenue ratio as a percentage of GDP.
- Nominal economic growth declined less than real growth which is shown in the table, leading to less pronounced balance effects in a nominal tax system.
- Tax revenue is running ahead of expectations, particularly in 2001.

Ranges are given below for the likely changes in GDP and in the budget balance. On the basis of historical GDP growth rates, the diagram shows, with a 70% probability, the extreme limits for nominal GDP and the budget balance as a percentage of GDP.

Diagram 7: Ranges for GDP in € bn (left-hand scale) and the government budget balance as % of GDP (right-hand scale), 2001 to 2005



Source: Federal Ministry of Finance.

At the end of 2000 €16.75 billion (ATS 230.6 billion) of Federal debt, or 8% of GDP, was denominated in yen and Swiss francs. A simultaneous 10% devaluation/revaluation of these currencies would, therefore, reduce/increase the debt ratio by some 0.8 percentage points of GDP.

The risks for the deficit of higher interest rates on government debt can also be regarded as slight. Some 90% of federal debt is borrowed at fixed interest rates and the residual life of existing debt was 5.7 years in October 2001. Compared with the standard scenario, a lasting increase in the average interest rates of 1 percentage point from 2002 would, on the basis of the existing debt structure, burden the government deficit in 2005 with some €0.13 billion.

5. Quality of public finances

Public finances in Austria have two main characteristics:

1. A very extensive and well-developed social security net that is provided primarily by the State and financed predominantly on a pay-as-you-go basis and through subsidies;
2. A very high share of public services provided directly by the State.

The upshot of these factors is a relatively high level of taxes and public charges.

The following chapter discusses trends in connection with population ageing. The present horizontal strategy for providing services is examined below.

The current government programme applies the following criteria for improving public services:

- achieving full transparency of the costs of new legislation;
- improving transparency of the cost breakdown of public expenditure;
- examining the need to provide public services through administrative procedures.

The federal budget includes provisions for increasing the cost transparency of measures. Moreover, the Federal Government intends to introduce cost accounting on a systematic basis.

The most recent tax measures were designed to close tax loopholes and to extend the tax bases. This will make the breakdown of costs for the taxpayer transparent, reduce free-rider behaviour and alleviate distortions in consumption and investment decisions.

The production of many goods and services through administrative methods is one of the reasons for the rapidly rising costs of performing public tasks. The current finance policy is, consequently, designed to tackle this problem. Administrative reform, the reform of public procurement, the limitation on lifetime tenure for civil servants and the measures at the level of the social insurance institutions are being deployed to reap the benefits of producing under market conditions also for the performance of public tasks.

In October 2000, building on the government programme of February 2000, the fiscal federalism partners agreed on an administrative reform with the following elements:

- dismantling of duplication in public administration; structural measures concerning tax offices, courts and the police; combination of administrative procedures at the level of district administrations; legislative simplification, transfer of responsibility for federal highways to the provincial authorities;
- administrative measures involving the federal ministries (such as merging of accounting and joint operation of vehicle fleets).

The following priorities have been set:
Administrative Reform Law: This omnibus law, which contains over thirty measures, sets out above all to make district administrations the first contact point for individuals. At the same time, lines of appeal are being shortened. In addition, independent administrative tribunals (UVS) are being granted the status of appeal authorities. A number of laws is revoked. The Administrative Reform Law was agreed by the government on 2 October 2001 and is expected to be adopted by parliament in early 2002.

Deregulation package: A whole series of laws are designed to simplify procedures and to dismantle any unduly strict regulations. The following are some practical examples: simplification and standardisation of building regulations; simplification of approval and test procedures under the Waste Disposal Industry Law and the Packaging Regulation; simpler procedures in the Law on cleaning up past pollution; reduction in registration red tape under the Motor Vehicle Law; but also amendments to the Wine Law, the Law on Associations and in the Foodstuffs Law. This deregulation package is supposed to be finalised by the end of next year.

Personnel reforms

The Federal Government's budget programme for the life of the present parliament (2000-03) stipulates that expenditure on public administration is to be held at roughly its 2000 level and that this will be achieved in particular by boosting productivity and efficiency. In the autumn of 2000, therefore, the government adopted a series of measures and has since implemented them.

At federal level, 11 000 full-time equivalent civil servant jobs that will show up in the figures for expenditure will be lost, excluding the redundancies at Telekom Austria AG and the postal administration that are planned by the end of 2003. In implementing the government programme, concrete target figures were set for the workforce as at 31 December 2001. For the period between January and September 2001 the federal workforce fell by 2.9%, compared with the same period last year; around 6 000 people were affected, of which some 1 500 by hive-offs.

A series of hive-offs were completed at the beginning of 2001. Other hive-offs, such as that involving banking and insurance supervisory activities, are being prepared. Together with the structural reforms that have been launched, a restrictive salary policy and flexibility measures will produce savings of around €0.39 billion in 2001 and €0.81 billion in 2002 (cumulative). Cumulative savings of €1.09 billion are envisaged for 2003.

Education

According to the European Commission communication on structural indicators, Austria ranks third in the EU as regards public spending on education. Education is the largest individual item of federal public expenditure in Austria. Under the new financial burdensharing arrangements, binding ceilings were introduced for teacher-pupil ratios in basic education. Schools are being granted greater independence. Special payments - not tied to seniority - for the administrative duties performed by teachers were introduced.

The universities, which are at present fully integrated into the federal administrative structure, are to become independent institutions with their own legal personality and with extensive capacity to act. This should improve research and teaching performance and improve international competitiveness. There will be greater flexibility and freedom, and the university will become a pro-active institution. As of the 2001 winter semester, a study fee of €363 per semester was introduced. At the same time, the system of fellowship grants and assisted loans was expanded.

The government has set itself the goal of increasing R&D as a proportion of GDP. Despite the ongoing consolidation programme, the public authorities will contribute. The Federal Government has earmarked a further €0.51 billion for the period 2001-03. The new Research Council will discuss ways of making optimum use of these resources so that they have maximum effect. A follow-up programme for the period 2004-06 is already under discussion.

In international comparison, the public share of research funding in Austria is comparatively high, particularly as a result of the substantial spending on universities. However, in countries with internationally above-average spending on research, such as Finland and Sweden, it is the corporate sector that provides the bulk of R&D funding. The government's offensive is designed, therefore, to provide the corporate sector with incentives and to mobilise firms' research potential. The resources earmarked will go primarily to "dynamic" projects and programmes conducive to sustained R&D activities by firms over the period in which assistance is provided. As a matter of priority, assistance will be given to new activities embarked on by innovative and research-intensive firms, business start-ups in universities (spin-offs) or cooperation between universities and industry.

6. Effects of population ageing on the sustainability of public finances

For Austria, the population projections by Statistik Austria and Eurostat predict a substantial increase in the proportion of older people in the population as a whole. This greying of the population will also have a considerable impact on the long-term financing of the public pension and health systems. The projections in Table 6 of are based on the population forecasts compiled by Eurostat in 1999 for the period 2000-50. They assume a decline in the Austrian population from the present figure of 8.1 million to 7.6 million in 2050. The ratio of those over 64 to the labour force will climb from its present level of 25% to 55% in the period 2040-50, while the increase in the proportion of those over 79 will be even more marked. The rise in this ratio will gather momentum particularly in the period 2020-40. According to the latest population forecast by Statistik Austria, the ratio would be 49% in 2050.

6.1. Pension system

The Austrian system of old-age insurance covers in various schemes all gainfully employed individuals. Entitlement to benefits normally depends on the period of membership of the relevant scheme and the amount of contributions made. The system is a pay-as-you-go system.

The declared objectives of Austrian pension policy include sustainability and quality assurance. The following measures were adopted in the wake of the 2000 pension reform:

- gradual increase in the statutory early retirement age by 1½ years (from 55 to 56½ for women and from 60 to 61½ for men);
- abolition of early retirement pension on grounds of work incapacity and introduction of a new vocational protection scheme in connection with invalidity pensions but only as of 57 years of age;
- increase in the effective retirement age by increasing the actuarial discounts for early retirement and/or additions when retirement is delayed;
- closer harmonisation of the various pension schemes in the private sector and of the special schemes for civil servants;
- deletion of the legal provisions governing retirement pensions so as to permit drawing of a pension and the simultaneous carrying on of a gainful activity, thereby facilitating in particular the smooth transmission to retirement;
- pension adjustments to be linked in future only to net wages, with higher inflation being cushioned by one-off payments;
- more marked reduction in the survivor's pensions where the surviving spouse has income of his/her own and/or is entitled to a pension;
- strengthening of the second and third pillars.

The government generally arranges for expert committees to prepare reform measures. A statutory commission (*Pensionsbeirat*) was set up on 1 October 2000 with the task of monitoring developments in pension insurance in the longer term. The commission is required to produce an annual medium-term forecast of developments in the statutory pension insurance scheme and - this is a new feature - to produce every three years a long-term report. The first long-term report is expected in 2003.

The pension reforms of 1997 and 2000 will make for savings equivalent to 0.8% of GDP, of which 0.5 percentage point by 2003. In order to cope with the main problems that will arise in the future, the following measures, which go beyond the 2000 pension reform, were adopted or are being planned:

- increase in the employment rate and activity rate;
- transparent financing structures thanks to a clearer classification of entitlements accruing from actual payments and of those parts accruing from "non-insurance" factors, and stronger reliance on actuarial considerations;
- strengthening of the three-pillar model via reform of the compensation payable on termination of employment or retirement in October 2001 under an agreement between the social partners, and the creation of a second pillar for newly recruited employees in the public sector (especially at federal level from 2000). A reform of invalidity pensions is currently under discussion.
- The various social insurance institutions are to be merged if this guarantees efficiency, reduced costs, other synergistic effects, accessibility for the public and continued quality assurance.

6.2. Health and care systems

The health system is based on the principle of coverage for all gainfully employed individuals and pensioners and their dependants. This means that some 99% of the population is covered by the state health system. Contributions are dependent on income, up to a ceiling. In terms of treatment, there is no distinction between insured persons, although there are various funds that provide different benefits.

In 2001 various initiatives were taken to achieve cost savings and to introduce control measures:

- a charge was introduced for the use of hospital walk-in services;
- in order to relieve the burden of in-patient care, the possibility of setting up group medical practices to provide flexible out-patient care was introduced;
- parallel imports of proprietary medicines are to be made easier in line with the case law of the European Court of Justice.

In order to continue to ensure a high degree of efficiency in the distribution of the care allowance, quality assurance will be stepped up (e.g. by checking that a copy of the care contract has been submitted) and efforts will be made to provide better social support for caring relatives.

Table 6 gives an initial overview of the possible budgetary consequences of ageing up to 2050 on the basis of Eurostat population forecasts. The data for the health and care sectors are based on initial (provisional) projections for age-specific expenditure profiles.

Table 6: Long-term sustainability of public finances

As % of GDP	**2000**	**2005**	**2010**	**2015**	**2020**	**2025**	**2030**	**2035**	**2040**	**2045**	**2050**
Pension expenditure	14.5	14.5	14.9	15.4	16.0	17.2	18.1	18.7	18.3	17.5	17.0
Health and care expenditure	5.8	6.0	6.3	6.6	6.9	7.1	7.5	7.9	8.1	8.4	8.5
Assumptions											
Productivity growth (labour)	2.0	2.0	1.9	1.9	1.8	1.8	1¾	1¾	1¾	1¾	1¾
Real GDP growth (five-year average)	2.5	2.3	2.1	1.8	1.5	1.3	1.2	1.4	1.6	1.6	1.3
Activity rate (men 15-64)	76.0	76.7	76.5	76.8	77.0	77.2	78.7	80.3	81.2	81.3	81.2
Activity rate (women 15-64)	58.7	60.8	61.7	61.5	61.7	62.4	64.7	67.4	69.0	69.7	70.1
Activity rate (overall 15-64)	67.4	68.8	69.2	69.2	69.4	69.9	71.8	74.0	75.2	75.6	75.8
Unemployment rate (EU definition)	3.7	3.7	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0

The calculations comply with the rules agreed in the EU's Economic Policy Committee and are based on Eurostat's population forecasts in 1999. The above is not a forecast but a model calculation.

7. Horizontal measures with an impact on public finances (structural and capital market policy)

Structural policy is directed towards improving the **attractiveness of Austria as a business location**, strengthening the country's international competitiveness and thereby securing and creating employment. The following measures are planned to that end:

<u>The Federal Government's capital market offensive</u>

The Austrian capital market is still significantly less developed than those in other countries broadly comparable in economic strength and structure. This fact and the forthcoming privatisations have prompted recent discussions. The following significant measures were implemented in December 2000:

- Admission of IPO prospectuses in English for securities; allowing publication of prospectuses on the Internet in accordance with the publication requirements laid down in capital market legislation; broadening the scope of the exemption from the obligation to produce a prospectus for euro securities.
- Reform of "other securities trading" on the Vienna stock exchange: transformation into a regulated market in accordance with Article 16 of the Investment Services Directive, with a ban on insider trading, plus disclosure obligations and market supervision.
- Stock exchange turnover tax was abolished on 1 October 2000.
- Inheritance tax to be abolished on 1 January 2001 where, in the case of holdings of less than 1%, shares in public limited companies, etc. are inherited through succession (not in the form of a gift).
- The current tax allowance of ATS 10 000 for the issue of employee shares was raised to ATS 20 000 on 1 January 2001.
- Stock options will be given preferential tax treatment under certain conditions
- Where allocations, up to a ceiling of ATS 20 000, are made from an employees' trust which holds shares only in the employer's firm, the employee will be subject to capital gains tax of only 25%.

Similarly, to improve corporate governance, the managing board's reporting obligations vis-à-vis the general meeting of shareholders are to be increased and the protection of minority shareholders improved.

On 1 April 2002 the separate financial market supervisory bodies will be merged into a single public-law institution (FMA) that will monitor the entire financial market in close cooperation with the Austrian National Bank. Enforcement powers and the power to impose administrative fines will also be assigned to this single institution. The FMA will thus be a very powerful body. Supervisory legislation will also be improved with a view to speeding up and implementing more effectively supervisory measures. The requirements imposed on bank auditors will be tightened even further, not only as regards their personal qualifications but also as regards ensuring audit reliability by introducing the rotation principle. In addition, the position of credit institutions' supervisory boards, which will, for example, be able to commission audits in support of their supervisory responsibilities, will be strengthened.

<u>Privatisation</u>

Privatisation of public enterprises and improvement of corporate governance are important goals of structural policy. Table 7 lists the measures that have been taken to date:

Table 7: Privatisations carried out by the Federal Government during the life of the present parliament

Nov. 2000	Sale of 100% of PSK to BAWAG	ATS 17.874 bn
Nov. 2000	Floating of 22.4% of TelekomAustria AG on the stock exchange and of 4.8% under contractual agreements to STET International (Telekom Italia)	ATS 13.888 bn
Nov. 2000	Sale of 2.62% of Flughafen Wien AG (in total 5.24%) to the Viennese city authorities and to the Province of Lower Austria and the floating of 3.22% following a share buy-back by Flughafen Wien AG	ATS 0.984 bn
Nov. 2000	Sale of Österreichische Staatsdruckerei GmbH (state printing works) to an Austrian investor	ATS 0.040 bn
March 2001	Floating of the remaining 8.92% in Flughafen Wien AG to national and international institutional investors	ATS 0.977 bn
April 2001	1% of VA Stahl AG to an employee participation foundation	ATS 0.139 bn
Aug. 2001	41.13% of Austria Tabak AG to Gallaher Group plc	ATS 10.585 bn
Sep. 2001	Dorotheum to private investors	approx. ATS 1 bn
Total		**ATS 45.487 bn** **€3.3 bn**

Privatisations still planned:

- Strohal Rotationsdruck GmbH (as subsidiary of Print Media Austria AG, which has been merged with ÖIAG);
- Telekom Austria AG (47.8%).

The privatisation proceeds did not accrue directly to public budgets but to the ÖIAG, which is 100%-owned by the Federal Government. The net financing liabilities of the ÖIAG fell from €6.29 billion (ATS 86.6 billion) on 1 January 2000 to €2.0 billion (ATS 27.5 billion) at the end of August 2001.

Labour market

The following measures are planned or have already been implemented:

Reduction of non-wage labour costs/labour costs by €1.09 billion (0.5% of GDP) by 2003, of which some €0.6 billion will affect the budget balance. Arrangements for proportional holiday allocation and abolition of the one-day leave entitlement to find a new job took effect on 1 January 2001. The employer's contribution to sickness insurance had already been reduced by 0.3 percentage point in 2000.

At the end of October 2001 the two sides of industry agreed on the new arrangements for the severance obligation: The previous arrangements dated basically from 1917 and were designed to make it more expensive for firms to abandon a particular area during the collapse of the Habsburg monarchy by obliging them to pay compensation to workers in proportion to their period of employment with the firm. This historical purpose lost all relevance many years ago. The social objective of the arrangements was increasingly frustrated because firms had an incentive to make employees redundant at certain times so as to avoid making higher payments. A fund was set up that assumed responsibility for severance payments in the event of insolvency. It was financed by a wage-related charge. The effect was to hamper the labour-market mobility of workers because they received no payments if they handed in their notice. The new arrangements have social and labour market objectives and are designed so as not to impair firms' competitiveness. The following rules have been introduced for new employment contracts:

- Severance claims will be hived off to financial institutions (similar to pension funds) and will be managed in individual accounts.
- Severance entitlement begins to accrue on the first day of employment (previously it accrued only from the third year) and irrespective of the reason for terminating the employment contract.
- The employer's contribution is equivalent to 1.53% of the wage bill.
- The claims (except where an employee hands in his notice) are paid out either immediately (after at least three years' employment with the firm) or, for example, only when the employee retires and may thus draw a supplementary pension.

By assessing severance contributions, financial cover for employees can be achieved similar to what existed previously and the number of beneficiaries can be increased from around 20% of employees to almost 100%.