COMMISSION OF THE EUROPEAN COMMUNITIES

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RESTRICTED

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No. 1466/97 of 7 July 1997

On the Updated Stability Programme for Austria, 2001-2005

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No. 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1], stipulated that countries participating in the single currency were to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on the assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). The Commission adopted a recommendation on each programme. On the basis of this recommendation and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme.

Austria's first stability programme covering the period 1998-2002 was submitted on 30 November 1998 and assessed by the Council on 18 January 1999[2].

According to the Regulation, the updated stability programmes, to be presented annually, may also be examined by the Council in accordance with these same procedures. The first annual update, covering the period 2000-2003, was submitted on 28 March 2000 and assessed by the Council on 8 May 2000[3]. The second annual update, covering the period 2000-2004, was submitted on 19 December 2000 and assessed by the Council on 12 February 2001[4].

Austria submitted its third and most recent update of the stability programme, covering the period 2001-2005, on 27 November 2001. The Commission services have carried out a technical evaluation of this updated programme, which warrants the following assessment:

> The updated Austrian stability programme has revised downwards the short-term macroeconomic outlook in comparison with the previous programme but continues to hold a favourable view on the medium-term perspective. Output growth is expected to pick up from its cyclical trough of 1.3% in 2001-02 to 2.4% in 2003 and further to 2.8% thereafter. Although being slightly above ECFIN's estimated trend growth, the projected 2¼ % average growth rate over the period 2000-2005 appears feasible as supply and demand conditions in the Austrian economy remain favourable. The projections are largely similar to the Commission services' autumn forecast.
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> Regarding government finances, the consolidation in the year 2001 was notable. General government finances are estimated to have attained balance in the year 2001, one year ahead of the schedule set out in the previous programme. Important expenditure measures were implemented, in particular reforms in the pension system and in public administration. Nonetheless, the consolidation strategy in 2001 relied predominantly on the revenue side. A series of mostly base-broadening tax measures resulted in a substantial increase in revenues despite the slowdown in GDP growth. In addition, tax receipts generated by newly introduced interest payments on tax arrears overshot expectations by roughly 0.5% of GDP. Thus, the revenue side consolidation was significantly higher than projected in the December 2000 stability

[1] OJ L209, 2.8.1997
[2] OJ C42/5, 17.2.1999
[3] OJ C162/1, 10.6.2000
[4] OJ C77/6, 9.3.2001

programme. In other words, the noteworthy budgetary improvement in 2001 was achieved through a significant increase in the tax burden. Taxes and social charges are estimated to have risen by 1.8 percentage points to an all time high of 47.1% of GDP, well above the EU15 average.

For the years to come, the balanced budgetary position is to be maintained until 2003 and, under no policy change assumptions, to increase to a small surplus thereafter. This projection is based on budgetary measures largely unchanged from those set out in the previous stability programme. In particular, structural expenditure savings should result from the continued effects of the reform of the pension system and public administration. In addition, expenditure savings have to be attained at the local government level. On the revenue side, the only modification concerns the envisaged reduction in non-wage labours costs, originally planned for 2002 and now postponed to 2003.

Under the projected path of the government balance Austria complies with the requirements of the Stability and Growth Pact from 2001 onwards. In cyclically adjusted terms the government accounts are projected to be in balance in 2001 and to move into a small surplus for the remainder of the programme period. Therefore, government finances in Austria should be able to withstand a normal cyclical downturn without breaching the 3% of GDP reference value for the deficit ratio.

In contrast to the year 2001, expenditure savings dominate in the later years of the programme, in particular in 2002 and 2003. The continued effects from the pension reform in 2000 and the ongoing reform of public administration as well as other expenditure cuts should result in substantial savings. However, these effects are partly counteracted by the introduction of a new child allowance as of 2002.

As in the previous programme significant consolidation efforts are also envisaged at the level of the provinces ("Bundesländer"). The Bundesländer committed themselves to run annual budget surpluses totalling 0.75% of GDP in the framework of the financial equalisation scheme between federal and local governments. These targets are binding and should be ensured by an internal stability pact. While in 2001 the budgetary objective is likely to be achieved thanks to higher tax revenues and some spinning-off measures, in the years to come substantial savings will be necessary in order to maintain these high surpluses. Yet, such savings remain largely undefined in the programme.

Some risks to the budgetary projection are to be noted for the year 2003, both on the revenue and on the expenditure side. As a consequence, in order to maintain the successful consolidation it is crucial to keep expenditure under strict control – at all levels of government - in 2003 and thereafter. This would be the more necessary as, in view of the sharp increase in the tax ratio in the year 2001, structural measures lowering the high tax burden should be implemented in the later years of the programme. As an important first step it should be ensured that the planned reduction in non-wage labour costs be implemented in 2003.

The debt-to-GDP-ratio is expected to fall below the 60% reference value in 2002 and to decline further thereafter. However, there is a certain risk that the reorganisation of federal real estate management - subject to its statistical classification - could increase public debt by more than 1½ percentage points. Under this scenario, the debt-to-GDP-ratio would drop to below the 60% threshold in 2003, one year behind schedule. Moreover, in the light of the significant population ageing in the next decades, bringing down the debt ratio decisively in the long run is called for.

As regards long term sustainability of public finances, it is to be noted that even after the pension reform effective since October 2000 Austria will continue to spend more on public pensions in terms of GDP than the other EU countries. To render the pension system sustainable in the longer term reform efforts need to be continued, as recommended in the Broad Economic Policy Guidelines. However, the updated programme does not outline any additional reform steps in this direction.

The programme refers to ongoing reforms on product, capital and labour markets. Despite a number of recent measures in these areas further efforts will be needed to render product markets more flexible and competitive and to increase capital market efficiency.

Based on this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the Stability Programme update of Austria and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No. 1466/97 of 7 July 1997

On the Updated Stability Programme for Austria, 2001-2005

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council regulation (EC) No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[5], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On [22 January 2002] the Council examined the updated stability programme for Austria which covers the period 2001-2005.

The updated programme projects general government finances to improve from a deficit of 1.1% of GDP in 2000 to a balanced position in 2001-03, and to move to a small surplus in the following years. The government gross debt is expected to decrease from 61.8% of GDP to slightly below the 60% reference value in 2002 and further to 52.1% in 2005. The Council notes with satisfaction that, in spite of lower-than-projected growth, the government deficit was reduced more rapidly than projected, i.e. one year ahead of the schedule presented in the previous programme.

The Council welcomes that important structural savings measures, notably in the fields of pensions and public administration, were realised in 2001; they contributed to bring down the government accounts to balance in 2001 and will continue to impact positively on spending over the programme period. This is in line with the Council's recommendations in the Broad Economic Policy Guidelines. The Council notes, however, that the deficit reduction in 2001 relied heavily on revenue side measures. As a consequence, the already high tax burden in Austria has risen more strongly than anticipated, thereby more than offsetting the effects of the 2000 income tax reform.

[5] OJ L209/1, 2.8.1997

The budgetary projections of the programme are based on a macro-economic scenario expecting annual output growth to resume from its cyclical trough of 1.3% in 2001 and 2002 to 2.4% in 2003 and to increase further to 2.8% in the following years, amounting to an annual average growth of 2¼ % over the forecast period. The Council considers that the expected growth is feasible given that no significant macroeconomic imbalances prevail and provided that social partners continue their policy of setting wages in line with maintaining international competitiveness.

The budgetary position is close to balance or in surplus from 2001 onwards and thus in line with the requirements of the Stability and Growth Pact. Also in cyclically adjusted terms the projections indicate that government finances in Austria should be able to withstand a normal cyclical downturn without breaching the 3% of GDP reference value for the deficit ratio.

The Council urges the Austrian authorities to ensure strict budgetary implementation at all levels of government. This is crucial to preserve budgetary balance, in particular in view of uncertainties regarding the impact of the economic slowdown. Moreover, at the level of the Bundesländer expenditure cuts are necessary to achieve the sustainable structural surpluses required by the national stability pact.

The Councils considers that attaining a budgetary surplus in 2004-05, as projected in the programme, is appropriate for Austria. A budgetary surplus in the medium term is central in bringing down the debt level decisively, which appears necessary in view of the long-term expenditure pressures resulting from population ageing.

The Council notes that the government finance projections rely on a revenue-to-GDP ratio which is clearly higher than that of most other Member States. Therefore, the Council encourages the Austrian authorities to consider a stronger than planned reduction in the revenue ratio, accompanied by an equivalent reduction in the expenditure ratio. A decisive decline in the tax burden, especially on labour, would be instrumental in rendering government finances more conducive to employment and output growth. In the short-term, the Council invites the Austrian government to implement the reduction in non-wage labour cost, already postponed by one year, as planned in 2003.

The Council furthermore considers that the Austrian government should continue the ongoing structural reforms and enhance its efforts in the pension system and the health care sector, as recommended in the Broad Economic Policy Guidelines. In particular, the Council invites the Austrian government to consider measures with a view to further raising the low effective retirement age and to encouraging labour market participation, in particular of older workers and women. The Council also encourages the Austrian government to continue with the reforms of product and capital markets, with a view to enhancing competition, fostering the provision of risk capital and improving entrepreneurial dynamism.