

AUSTRIAN STABILITY PROGRAMME

Update for the period 2005 to 2008

(working translation)

**Federal Ministry of Finance
Vienna, November 29th, 2005**

**Federal Ministry of Finance
Vienna, November 2005**

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1. Introduction and summary

In accordance with Regulation (EC) No 1466/97, amended by Regulation 1055/2005, Member States are required to submit a stability programme (members of EMU) or a convergence programme (non-members). Austria herewith submits its update for the period 2005 to 2008. The programme's structure reflects the agreements reached by the ECOFIN Council on October 11th, 2005 (*Code of Conduct*).

With this update Austria is firmly committed to the goals of the Stability and Growth Pact. Sound and sustainable public finances are the basis for the successful implementation of structural reforms aiming at higher growth and more jobs.

With regard to its economic policy the Austrian government follows a three-pronged strategy:

- **Balanced budget over the economic cycle**
- **Lowering the tax burden to less than 40% of GDP by 2010**
- **Raising potential growth via fostering investment in research, education and infrastructure**

Successful implementation of this strategy increases the attractiveness of Austria as a business location in the context of international competition. Some of the economic policy goals of this government have been implemented already, or will be reached within the time horizon of this programme:

- **Comprehensive tax reform in the years 2004 and 2005, resulting in a substantial lowering of the tax burden**
- **Continued policy of tax relief**
- **Continued structural reforms on the expenditure side of public households (Administrative Reform, Health Reform Act, Pension reforms)**
- **Creation of a single unified scheme and achievement of long-term fiscal sustainability of the pension systems**
- **Balanced budget at the general government level by the year 2008 and declining debt ratio**
- **Growth and Employment Packages: +1.4 percentage points of GDP and 63,000 more jobs until 2006 compared to a scenario without any measures taken since 2002**
- **Without growth and employment measures, a close to balanced budget would have been recorded without interruption since 2001**
- **Better environment for business investment due to deeper capital markets and due to Vienna's stronger position as a centre of international finance**

The figures for public households presented in this update are based on a cautious economic outlook until 2008 taking into account the medium term outlook for growth by the Austrian Institute of Economic Research (WIFO). In addition, the most important structural reforms on the expenditure side of public households which aim to raise the long run growth potential of the Austrian economy, are presented in this update.

This document can be retrieved from the website of the Austrian Federal Ministry of Finance at: <http://www.bmf.gv.at>

2. The Austrian economy in the period 2001 to 2008

2.1. Economic developments until 2004

After the trough in the international business cycle in the year 2001, growth of the Austrian economy recovered faster than the average of the Eurozone indicating a high degree of flexibility of the Austrian economy. In addition, bringing forward infrastructure investment has strengthened internal demand. The increased investment premium has fuelled investment expenditure for business equipment in the year 2003. In 2004, due to a high degree of price competitiveness and a continued reorientation towards fast growing markets (in Central, Eastern and South-Eastern Europe, in North America and Asia), Austria benefited in a disproportionate manner from the strong growth in international trade.

Figure 1 shows growth developments in Austria in comparison with those of the German economy, its main trading partner, and with those of the Eurozone until 2004.

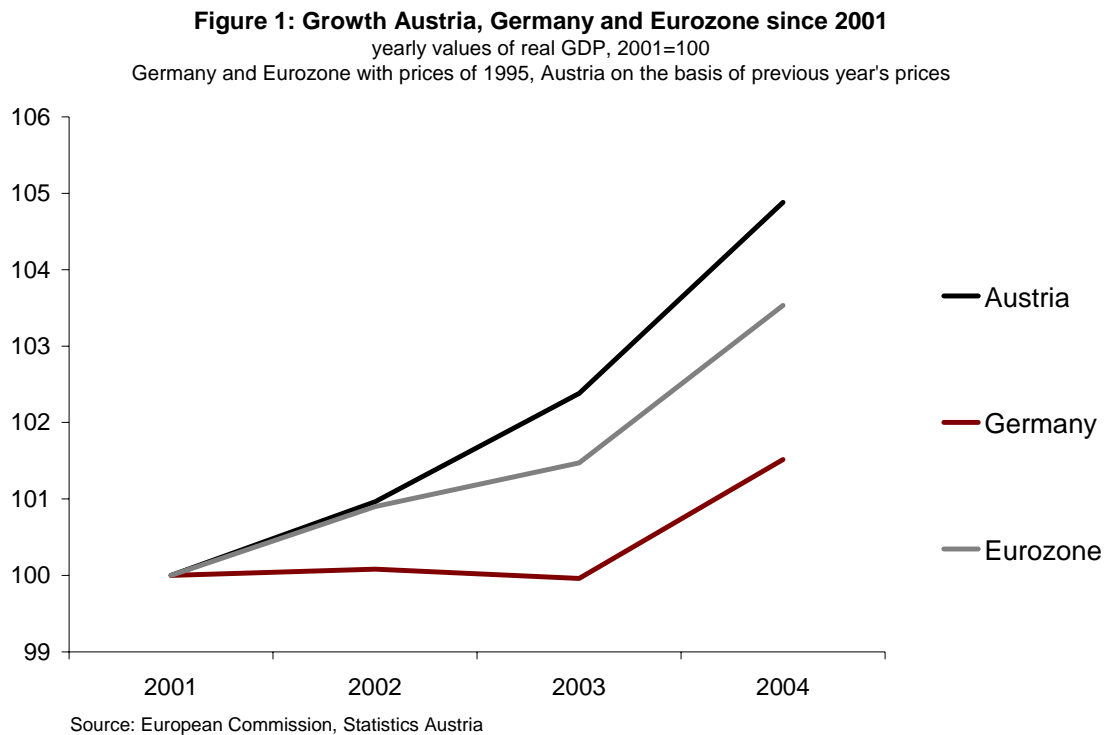
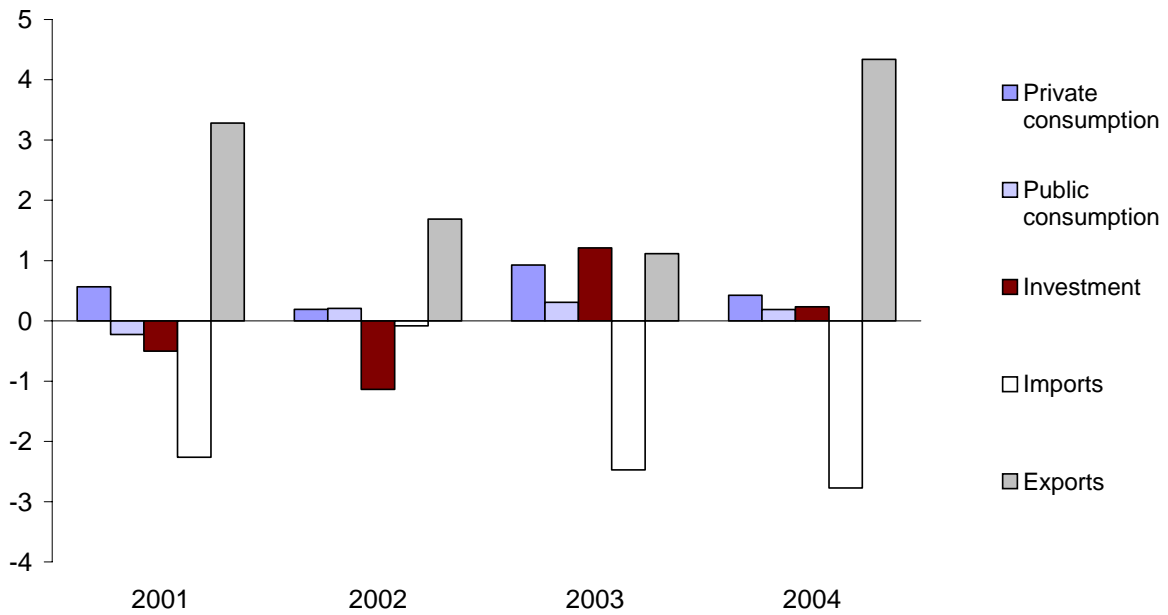


Figure 2 displays the contributions to growth of the expenditure components of GDP for the last 4 years. After the international slowdown in growth in the year 2001, internal demand reached its trough in 2002. In 2003, the increased investment premium and other measures in the context of the Stimulus Packages I & II as well as the Growth and Competitiveness Package 2003 led to a significant pick-up of investment demand. Similarly, demand by private households accelerated to a rate of 1.6%. Taken together, investment and private household consumption demand gave a boost to import demand. In 2004, exports, taking over from internal demand, became the driving force of Austrian growth.

Figure 2: Contributions to growth 2001 - 2004 in percentage points of GDP
 (real growth rates of components of GDP weighted with previous years nominal shares)



Source: Statistics Austria

In 2004 and so far in 2005, the development of consumer prices (HCPI) closely resembled that of the Eurozone (figure 3).

Figure 3: Consumer prices

Austria and Eurozone 2001-2005, monthly values, year on year change in %

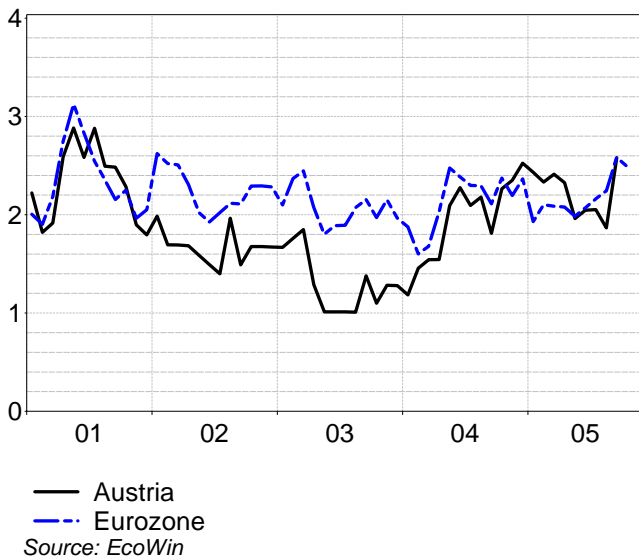
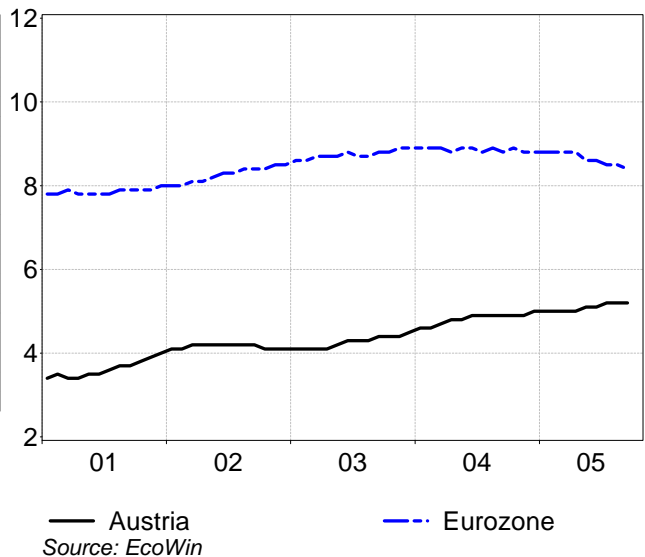


Figure 4: Unemployment rates

Austria and Eurozone, 2001-2005, standardised, in %



Dependent employment continues to grow. By the end of October 2005 the figure was 3.266,266, which corresponds to a year to year growth of 1.2 percent. Thus, employment growth in October reached its highest value since the year 1992, when year on year growth reached 1.5 percent.

However, as in previous years, labour supply growth was again even more dynamic than employment. The number of job-seekers in October was 237,582, which is a substantial increase over last year's figure. The standardised rate of unemployment according to EUROSTAT is currently 5.2% (September 2005). A new statistical methodology has led to an upward revision of this indicator, which makes comparisons of this indicator with data before the year 2004 impossible. Compared to the average unemployment rate in the Eurozone, Austria still exhibits a very low rate (figure 4).

Long term interest rates have reached historical lows in 2005. The rate of return on 10 year government bonds was 3.5 percent by mid-November after having reached historical lows of 3.0 percent in September. The spread with the German 10 year bond was consistently negative throughout the first quarter of 2005 and remains within a range of -5 to 10 basis points (figure 5).

In the last update, the value of the US Dollar with respect to the euro was expected to fall considerably in the medium term. This expectation did not materialize. Quite to the contrary, the euro has lost around 14% of its value vis-à-vis the U.S. American currency. For Austrian exports, the real effective exchange rate is crucial. The real effective exchange rate has fallen by roughly 1 percent since the end of 2003.

Figure 5: Long term interest rates
in %, Austria and Germany since 2001
and spread in basis points (rhs)

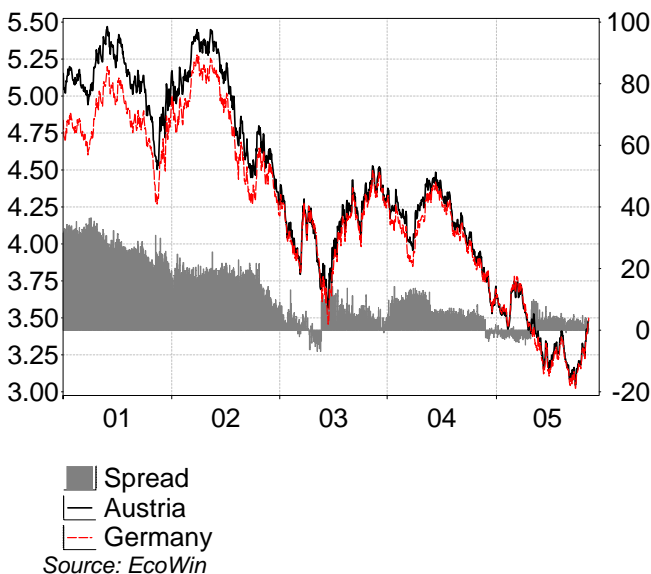
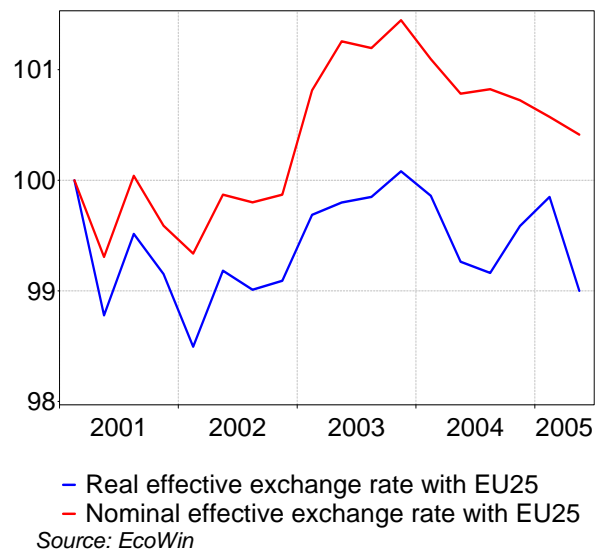


Figure 6: Effective exchange rates
nominal and real, 2001 to 2005
(1st quarter 2001 = 100)

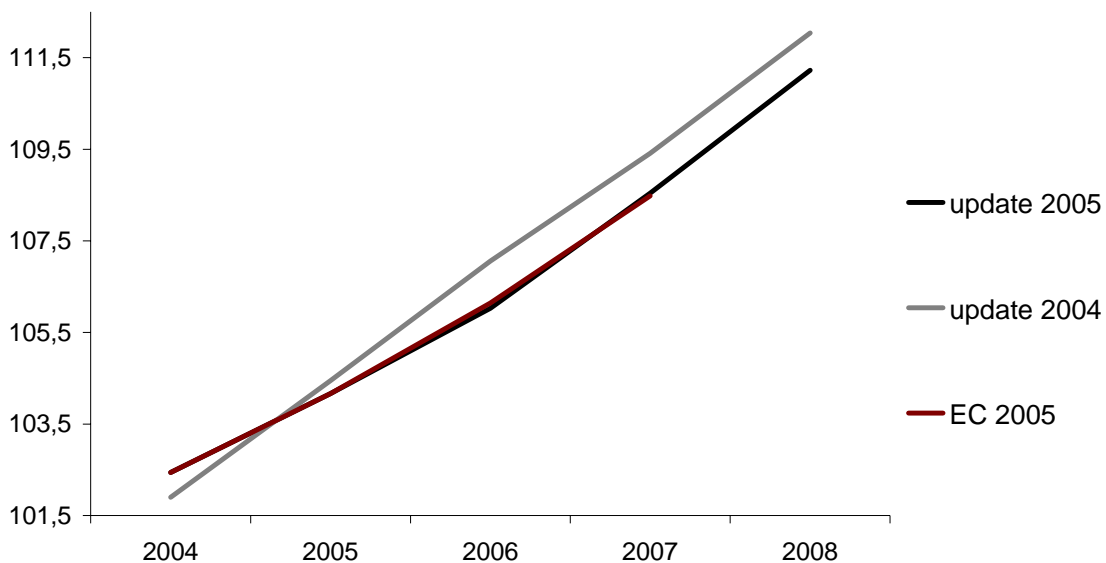


After a surplus of 0.75bn € in the year 2004 (preliminary figure), the development of the current account in 2005 is positive as well. The Austrian Institute of Economic Research currently expects a surplus of 0.5% of GDP and 0.4% of GDP in 2005 and 2006 respectively (table 1d). Given the cautious assumptions with regard to growth of export markets, there are some positive risks in this forecast.

2.2. Economic developments in the period 2005 to 2008

Due to slower growth of international trade and, above all, due to significantly higher energy prices, the economic recovery is going through a soft patch in 2005 and 2006. From 2007 on, given the continued increase in price competitiveness of the Austrian export industry, a typical pattern of the business cycle should emerge, with growth impulses coming first from investment demand and feeding through to stronger private consumption in 2008 (table 1a). This development is sustained by a dampening of inflationary pressures, as energy prices are stabilizing on a high level (table 1b). Net exports, given a medium growth scenario of Austrian export markets, continue to provide positive contributions to growth. The macroeconomic scenario bears close resemblance to the one in the EC's autumn forecast (figure 7).

Figure 7: Comparing the growth scenario with the EC forecast
real GDP 2003=100



Source: Statistics Austria, European Commission, WIFO, Federal Ministry of Finance

Tables 1a to 1d provide an overview of the economic developments for the time horizon of this update. The figures for 2005 and 2006 correspond to those of WIFO's September 2005 forecast. Estimates for 2007 and 2008 are derived from a model based forecast (as of early October 2005). The positive and negative risks of this forecast for growth and public finances are discussed in chapter 4. The output gap does not close before the final year of the programme period (see also table 5). Equally, in the final year the employment gap with respect to the NAIRU is closed.

Table 1a. Macroeconomic prospects

	ESA Code	2004	2004	2005	2006	2007	2008
		Level bn €	rate of change in %				
1. Real GDP	B1*g	232.5	2.4	1.7	1.8	2.4	2.5
2. Nominal GDP	B1*g	237.0	4.4	3.5	3.7	4.0	3.9
Components of real GDP							
3. Private consumption	P.3	129.5	0.8	1.4	1.7	1.9	2.0
4. Government consumption	P.3	41.5	1.0	0.7	0.1	0.8	0.8
5. Gross fixed capital formation	P.51	48.9	0.6	0.4	2.4	4.0	3.6
6. Changes in inventories and net acqu. of valuables (% of GDP)	P.52 + P.53	1.0	0.1	-0.1	-0.1	0.0	-0.1
7. Exports of goods and services	P.6	119.6	9.0	3.4	4.3	5.4	5.8
8. Imports of goods and services	P.7	108.0	6.2	1.8	3.9	5.1	5.2
Contributions to real GDP growth							
9. Final domestic demand			0.8	1.0	1.5	2.0	2.0
10. = 6.			0.1	-0.1	-0.1	0.0	-0.1
11. External balance of goods and services	B.11		1.6	0.9	0.4	0.4	0.6

Positions may not sum up due to rounding errors.

Source: Statistics Austria, WIFO, Federal Ministry of Finance

Table 1b. Price developments

	2004	2004	2005	2006	2007	2008
	Level bn €	rate of change in %				
1. GDP deflator		1.9	1.8	1.8	1.6	1.4
2. Private consumption deflator		2.0	2.4	2.1	1.7	1.4
3. HICP	112.3	2.0	2.3	2.1	1.7	1.5
4. Public consumption deflator		1.9	2.1	2.5	1.7	1.7
5. Investment deflator		1.7	2.2	1.8	1.5	1.4
6. Export price deflator (goods and services)		1.0	1.5	1.0	1.0	0.9
7. Import price deflator (goods and services)		1.2	2.7	1.5	1.0	1.0

Source: Statistics Austria, WIFO, Federal Ministry of Finance

Table 1c. Labour market developments

	2004	2004	2005	2006	2007	2008
	Level	rate of change in %				
1. Economically active persons	3.451,963	0.7	1.0	1.0	1.1	1.0
2. Hours worked (in millions)	6,781	0.3	-	-	-	-
3. Unemployment rate EUROSTAT (%)		4.8	5.2	5.1	5.0	4.9
4. Labour productivity, persons	67,353	1.7	0.7	0.8	1.3	1.5
5. Labour productivity, hours worked	34.3	2.2	-	-	-	-
6. Compensation of employees	116.6	2.5	3.4	3.7	3.5	3.6

Source: Statistics Austria, WIFO, Federal Ministry of Finance

Table 1d. Sectoral balances

% of GDP	ESA Code	2004	2005	2006	2007	2008
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	0.3	0.5	0.4	0.5	0.6
<i>of which:</i>						
- Balance of goods and services		2.0	2.2	2.2	2.4	2.6
- Balance of primary incomes and transfers		-1.7	-1.7	-1.7	-1.9	-2.0
- Capital account		0.4	-0.5	-0.4	-0.5	-0.5
- Acquisition/disposal of non-produced non-financial assets		-0.1	0.0	0.0	0.0	0.0
2. Net lending/borrowing of the private sector	B.9/	2.0	2.4	2.1	1.3	0.6
<i>of which:</i>	<i>EDP B.9</i>					
2a. private households		4.0	-	-	-	-
2b. non-financial corporations		-3.2	-	-	-	-
3. Net lending/borrowing of general government	B.9	-1.0	-1.9	-1.7	-0.8	0.0
4. Statistical discrepancy		-0.7	0.0	0.0	0.0	0.0

Source: Austrian National Bank, WIFO, Federal Ministry of Finance

3. Economic policy up to 2008

3.1. Economic policy strategy, budgetary policy and medium-term objective

The priorities of the Austrian government's medium-term budgetary policy form a three-pronged strategy:

- Balanced budget over the economic cycle
- Lowering the tax burden to less than 40% of GDP until 2010
- Raising potential growth via fostering investment in research, education and infrastructure

The general government deficit of 1.0% of GDP in 2004 was slightly lower than projected in the update of November 2004. In 2005 and 2006, the Austrian government temporarily accepts higher deficits as a result of the tax reform in order to strengthen the purchasing power of private households and to provide a more favourable environment for business activity in a sustained manner.

The tax burden will fall to below 41% of GDP in the year 2006 already. Therefore, the goal of reducing the tax burden to less than 40% of GDP no later than 2010 seems to be well within reach.

The measures providing for an increase of funds for research and development were described already in the last update. The funds dedicated to this policy-initiative, that was initiated in the years 2000 to 2003, will be more than doubled in the period 2004 to 2008. In 2005, R&D-expenditures will reach 2.35% of GDP, by 2010 a share of 3.0% of GDP shall be attained.

The Regional Employment and Growth Initiative 2005/2006, that was politically agreed upon in August, is providing positive incentives for business to invest in the respective regions and thus create more jobs.

In the area of labour markets, the *law for enhanced employment prospects* (Spurring Employment Initiative), that was passed on 28 September 2005, provides 285m € of additional funds for active labour market policies. This constitutes an increase of some 40%. These additional funds are designed to reverse the current labour market trend and shall be spent in the following areas:

- to qualify people for work in the health and care professions
- the *Jobs for You(th)* programme to increase qualification levels of young persons
- a business premium for the creation of additional places for vocational training
- combined wage bonus

For a detailed description of measures in the areas of research, education, infrastructure and labour markets we refer to the current National Reform Programme.

3.2. Public finances in 2005

The implementation of the budget for 2005 is on track. Comparing the various revenue and expenditure shares and the absolute values with those in the last update, there are hardly significant changes. However, one has to bear in mind the following:

In 2004, nominal GDP was higher than expected in the last update. This translated into higher revenues and expenditures. Since real growth came out higher as well, the budget balance improved by 0.3 PP of GDP. The higher values in 2004 create a base effect for the following year. On the other hand, nominal GDP growth in 2005 is lower than expected. For the fiscal shares it follows, that after an accelerated decrease in 2004 the dynamics have become somewhat flatter throughout the time horizon of this programme.

Looking at absolute figures, higher revenues from direct taxes (e.g. due to higher than expected corporate profits) and higher expenditures (higher spending on personnel in education and security, higher costs for the provision of public goods due to the increased overall price level, additional expenditures for labour market measures) roughly balance in the year 2005.

Regardless of the position in the business cycle, the 2005 budget sets the following priorities in accordance with the goals of the Austrian economic policy:

The development of the revenue side is dominated by the implementation of the tax reform 2004/2005. The first step of 2004 reduces revenues in 2005 by some 300m €. The second step of the reform lowers revenues in 2005 by an additional amount of 1.8bn €. In combination with the lowering of non-wage labour costs this amounts to a decrease in taxes and contributions of 2.2bn €.

On the expenditure side, the focus is on measures to strengthen Austria as a business location and to improve the structural features of the Austrian labour market. The measures of the two Stimulus Packages and the Growth and Competitiveness Package translate into additional expenditures of 1.3bn €. To this, one has to add an extra 250m € for R&D subsidies (R&D Initiatives II & III, Research Premium for third party research). Thus, the budgetary policy paves the way to achieve a R&D share of 3% of GDP by the year 2010.

The federal budget 2005 also provides more resources in the following areas (increase in expenditure in millions of € compared to the final accounts 2004 of the Austrian Court of Audit):

- Internal security and justice affairs: +110
- Defence and foreign affairs matters: +50
- Kyoto-measures: +30
- Social security (transfers for care increase by 2% from January 1st, 2005): +170
- Family transfers: +140

Expenditures turned out lower than expected in the areas of financial administration and pensions. The Administrative Reform, that has lowered expenditures on the federal level by a cumulative 7.4bn € between 2000 and 2006, continues to be implemented (on this see also chapter 5).

In total, expenditures rise by slightly less than 3% in 2005 whereas nominal GDP growth can be expected to amount to at least 3.5%. The expenditure share, which in 2004 fell under 50% of GDP for the first time since 1980, continues to decline to 49.5% of GDP in 2005 (table 2). The Maastricht deficit of the central government is expected to be 2.4% of GDP (which already takes into account the flood-related expenditures in 2005), for the general government a deficit of 1.9% of GDP is being targeted. This also corresponds to the value targeted in the last update (see also chapter 4).

3.3. Public finances from 2006 to 2008

On the revenue side, the 2006 budget is also affected by the tax reform 2004/2005. Actually, the biggest part of the overall effect on public revenues falls into this year (see table 2A). The first step reduces revenues in 2006 by some 500m €; this reduction becomes a permanent one from 2006 onwards. The second step of the tax reform reduces revenues in 2006 by 3.1bn €. Here, the lagged impact of the lowering of the statutory corporate tax rate to 25% comes into play and reduces revenues in 2006 in a disproportionate manner. In combination with the lowering of non-wage labour costs starting in 2004, the decrease in taxes and contributions in 2006 amounts to 3.7bn € (1.5% of GDP) compared to a situation, where no reform had taken place.

Other developments on the revenue side include lower expected dividends (minus 100m €) and lower revenues from public equity holdings (minus 350m €) compared to the year 2005.

On the expenditure side, the measures to strengthen Austria as a business location and to improve the structural features of the Austrian labour market continue in the year 2006. The measures of the two Stimulus Packages and the Growth and Competitiveness Package translate into additional expenditures in 2006 of 0.9bn €. To this, one has to add an extra 320m € for R&D subsidies (R&D Initiatives II&III, Premium for third party research), an increase of 30% compared to 2005. In 2006, more than 400m € are put into specific (temporary) growth and employment initiatives in the area of labour markets (see table 2A).

In addition to that, the federal budget 2006 sets the following priorities (increase in expenditure in millions of € compared to the 2005 budget):

- EU presidency: +25
- Kyoto measures +30
- Education and cultural matters: +62
- Transfers for care: +12.6
- Contribution to international fund for catastrophe relief: +100

The phasing-out of the increased investment premium lowers expenditure by some 600m € compared to 2005. Furthermore, higher than expected savings in the financial administration reform during 2005 should create a base effect for 2006. Until the end of 2004, the reduction in employment within the federal administration alone amounted to 13,000 full time equivalents. On 15 November 2005, the political agreement on the Administrative Reform II defined a reduction in expenditures for all levels of government of 1.9bn € until the year 2010. This includes a reduction in public employment by 15,667 full time equivalents (see also chapter 5). Collective consumption as a share of GDP (table 2) is reduced substantially and in a sustained manner, and the relative share of public expenditure for general public services continues to fall (table 3).

In 2007, temporary effects that worsen the budget balance in 2006 by around 1bn € cease to exist. The permanent reduction of the tax burden via the tax reform, via permanent measures of the Stimulus Packages I & II, as well as via the lowering of non-wage labour costs will amount to some 4.4bn € per year from 2007 onwards (table 2A).

Without these measures, Austria would have exhibited a close to balanced budget in every single year since 2001.

This observation is also reaffirmed in cyclically adjusted terms. In view of the fact, that the output gap calculated by the European Commission services is widening in 2005 and 2006, these demand boosting measures were justified and were implemented in a timely manner. Thus, a sharper slowdown of growth to the detriment of long term growth and employment was successfully avoided. Calculations by the Austrian Institute of Economic Research (WIFO) and by the Federal Ministry of Finance show, that, without growth enhancing economic policies, in 2006 real GDP could be 1.4PP (or 3.4bn €) lower, and the accumulated effect on employment is estimated at 63,000 jobs for the period 2002 to 2006.

Table 2A: Budgetary effects of stimulus packages and tax reforms

	2002	2003	2004	2005	2006	2007	2008
in millions of €							
Stimulus Packages I & II (2001/2002)	81	849	992	864	714	614	614
Growth and Competitiveness Package (2003)			105	470	150	150	150
Modified VAT on imports (2003/2004)		250					
Tax reform 2004			29	293	483	483	483
Tax reform 2005			200	1,765	3,083	2,558	2,558
Lower non-wage labour costs			153	153	153	153	153
R&D Initiative I	148	94	162				
R&D Initiative II			180	200	220	220	220
R&D Initiative III (May 2005)				50	75	100	150
Premium for third party research (May 2005)					25	50	50
Apprentice Initiative (Blum premium, May 2005)				5	15	15	15
Subsidy on high speed internet (May 2005)				10			
Regional Employment and Growth Initiative (August 2005)					185		
Spurring Employment Initiative (September 2005)					228	57	
Total	229	1,193	1,821	3,810	5,330	4,400	4,393
% of GDP	0.1	0.5	0.8	1.6	2.1	1.7	1.6
Net lending/borrowing, % of GDP	-0.4	-1.2	-1.0	-1.9	-1.7	-0.8	0.0
Net lending/borrowing without measures, % of GDP	-0.3	-0.7	-0.2	-0.3	0.4	0.9	1.6

Source: Federal Ministry of Finance

Table 2. General government budgetary prospects 2004 - 2008

		2004	2004	2005	2006	2007	2008
	ESA Code	Level	% of GDP				
	EDP B.9		Net lending by sub-sector				
1. General government	S.13	-2.3	-1.0	-1.9	-1.7	-0.8	0.0
2. Central government	S.1311	-3.3	-1.4	-2.4	-2.2	-1.4	-0.8
3. State government (without Vienna)	S.1312	0.7	0.3	0.4	0.4	0.6	0.6
4. Local government (including Vienna)	S.1313	0.4	0.2	0.3	0.2	0.2	0.2
5. Social security funds	S.1314	-0.1	0.0	-0.1	-0.1	-0.1	0.0
General government							
6. Total revenue	harmonised	115.7	48.8	47.6	46.9	46.8	46.7
7. Total expenditure	harmonised	118.0	49.8	49.5	48.5	47.6	46.7
8. Net lending/borrowing (6-7)	EDP B.9	-2.3	-1.0	-1.9	-1.7	-0.8	0.0
9. Interest expenditure	EDP D.41 incl. FISIM	7.3	3.1	3.0	2.9	2.8	2.7
<i>p.m.: 9a. FISIM</i>		0.3	0.1	0.1	0.1	0.1	0.1
10. Primary balance		5.0	2.1	1.1	1.2	2.0	2.7
Selected components of revenue							
11. Total taxes (11=11a+11b+11c)		66.1	27.9	27.1	26.3	26.1	26.0
<i>11a. Taxes on production and imports</i>	D.2	34.3	14.5	14.3	14.1	14.0	13.9
<i>11b. Current taxes on income, wealth</i>	D.5	31.6	13.3	12.8	12.2	12.1	12.0
<i>11c. Capital taxes</i>	D.91	0.2	0.1	0.1	0.1	0.1	0.1
12. Social contributions	D.61	38.1	16.1	16.0	15.9	15.8	15.8
13. Property income	D.4	3.2	1.4	1.2	1.2	1.3	1.4
14. Other		8.3	3.5	3.5	3.5	3.6	3.7
15=6. Total revenue	harmonised	115.7	48.8	47.6	46.9	46.8	46.7
Selected components of expenditure							
16. Collective consumption	P.32	16.5	6.9	6.9	6.8	6.6	6.5
17. Total social transfers	D.62 + D.63	71.3	30.0	30.0	29.7	29.5	29.2
17a. Social transfers in kind	P.31=D.63	26.0	10.9	10.9	10.8	10.7	10.6
17b. Social transfers other than in kind	D.62	45.4	19.1	19.1	18.9	18.8	18.6
18.= 9.		7.3	3.1	3.0	2.9	2.8	2.7
19. Subsidies	D.3	6.9	2.9	2.8	2.7	2.6	2.6
20. Gross fixed capital formation	P.51	2.5	1.1	1.0	1.0	1.0	1.0
21. Other		13.7	5.8	5.9	5.4	5.1	4.8
22=7. Total expenditure	harmonised	118.0	49.8	49.5	48.5	47.6	46.7

Positions may not sum up due to rounding errors.

Source: Statistics Austria, WIFO, Federal Ministry of Finance

3.4. Development of the structure of public expenditures

The goals of Austrian economic policy also show up in a changing composition of public expenditure. Since this illustration of the structure of public expenditure constitutes a new feature in stability and convergence programmes, we also included the values for the year 1998. Over a 10-year-period, the structural reforms on the expenditure side become more visible still. In the year 1998 expenditures for general public services and interest payments still amounted to 17.4bn € (that corresponded to a share of 17% in total public expenditures). Until 2003, expenditures on these items were lowered to 16.9bn €. Until the year 2008 these expenditures are further reduced to 15.7bn €. By then, the relative share of expenditures for general public services and interest payments will have fallen by some 5 percentage points below the value of 1998. This exemplifies the effects of the ongoing structural reforms, that are being implemented via the Administrative Reforms I & II and the pension reforms (see also chapter 5).

There is a relative increase in those expenditures which make a contribution to raising the growth potential of the Austrian economy (R&D, education). Also, there are higher expenditures on environmental issues (Kyoto-related measures). Due to the more favourable position in the business cycle, expenditures on economic affairs should be substantially lower in 2008 relative to other expenditure categories. In a similar vein, this is also the case for expenditures for social protection, where dampening effects of the pension reforms are kicking in as well between 2003 and 2008 (see also table 7).

Table 3. General government expenditure by function

in billions of €	COFOG Code	1998	2003	2008 ¹⁾
1. General public services	1	17.4	16.9	15.7
2. Defence	2	1.8	2.0	2.2
3. Public order and safety	3	2.9	3.2	3.8
4. Economic affairs	4	9.0	11.7	13.0
5. Environmental protection	5	0.7	0.9	1.2
6. Housing and community amenities	6	1.9	1.6	1.8
7. Health ²⁾	7	14.9	14.9	18.1
8. Recreation, culture and religion	8	2.1	2.2	2.5
9. Education	9	11.3	13.1	16.1
10. Social protection	10	40.8	48.4	54.1
11. Total expenditures (in billions of €)		102.6	114.9	128.4

1) Forecast.

2) Structural break in the year 2001; values between 1998 and 2003 are not directly comparable.

Source: Statistics Austria, Federal Ministry of Finance

3.5. Development of the ratio of general government debt

The development of the path of the public debt ratio in table 4 constitutes a cautious projection. Possible revenues from privatisations in the years 2007 and 2008 were not taken into account. The implicit interest rate on the public debt further converges to the long term market interest rate. On December 31st, 2004, the total public debt amounted to 150.767bn € (63.6% of GDP). The debt ratio will fall to below 60% of GDP in the year 2008 for the first time since 1992.

Table 4. General government debt developments 2004 - 2008

% of GDP	2004	2005	2006	2007	2008
1. Gross debt	63.6	63.4	63.1	61.6	59.5
2. Change in gross debt ratio	-0.8	-0.2	-0.3	-1.5	-2.1
Contributions to change in debt ratio					
3. Primary balance	-2.1	-1.1	-1.2	-2.0	-2.7
4. Interest expenditure (incl. FISIM)	3.1	3.0	2.9	2.8	2.7
5. Stock-flow adjustment	1.0	0.1	0.2	0.2	0.2
p.m. implicit interest rate on debt	4.9	4.8	4.7	4.5	4.5

NB: Figures may not sum up due to rounding errors.

Source: Statistics Austria, Federal Ministry of Finance

3.6. Cyclical and budgetary developments 2004 to 2008

The cyclically adjusted deficit temporarily rises to 1.5% of GDP in 2005 and 1.3% of GDP in 2006. A balanced budget, also in cyclically adjusted terms, is reached again in 2008 (table 5). Without the Stimulus Packages I & II, the Growth and Competitiveness Package 2003 and the tax reform 2004/2005, budget surpluses would have been attained already in 2006, rising to 1.6% of GDP by 2008 (table 2A). Since the budgetary effects of the tax reform mainly fall in the years 2005 and 2006, whereas structural reductions in expenditure take place throughout the time horizon of this update, the deficit is temporarily higher in those two years. From 2007 on, temporary effects amounting to 0.4 PP of GDP cease to exist. As a result, the reduction in the structural deficit accelerates accordingly.

The supply side measures outlined above and the structural savings on the expenditure side are designed to raise the Austrian potential long run growth, via a more efficient allocation of scarce resources and an enhanced innovation system.

Table 5. Cyclical developments

% of GDP	ESA Code	2004	2005	2006	2007	2008
1. Real GDP growth (%)		2.4	1.7	1.8	2.4	2.5
2. Net lending of general government	EDP B.9	-1.0	-1.9	-1.7	-0.8	0.0
3. Interest expenditure (incl. FISIM recorded as consumption)	EDPD.41 +FISIM	3.1	3.0	2.9	2.8	2.7
4. Potential GDP growth according to EC (%)		1.9	2.0	1.9	2.0	2.1
<i>contributions:</i>						
- labour		0.2	0.2	0.2	0.2	0.2
- capital		0.8	0.7	0.7	0.7	0.8
- total factor productivity		1.0	1.0	1.0	1.1	1.1
5. Output gap		-0.5	-0.7	-0.9	-0.5	-0.1
6. Cyclical budgetary component		-0.2	-0.4	-0.4	-0.2	-0.0
7. Cyclically-adjusted balance		-0.8	-1.5	-1.3	-0.5	0.0
8. Cyclically-adjusted primary balance		2.3	1.5	1.6	2.3	2.7

NB: Figures may not sum up due to rounding errors.

Source: European Commission, Statistics Austria, WIFO, Federal Ministry of Finance

4. Sensitivity analysis and comparison with previous update

After growth in 2004 came out higher than expected and since the oil price shock has caused a soft patch in the growth performance in 2005, the economy is expanding along a different path compared to the macroeconomic prospects in the previous update. In the baseline scenario of this update, real GDP is some 0.8% lower in the years 2007 and 2008 compared to the corresponding figures in the update of November 2004.

4.1. Comparison with previous update

Table 6 shows that in 2004 growth was higher and a correspondingly lower deficit could be attained. For 2005 and 2006, a slightly weaker growth development is expected. In spite of this fact, the budgetary targets for general government net lending can be adhered to from today's point of view. Hence, the worsening of the cyclically adjusted budget balances due to the tax reform is smaller, and the return to the medium term objective of a balanced budget is accelerated compared to the previous update.

Table 6. Divergence from previous update

	ESA Code	2004	2005	2006	2007	2008
Real GDP growth (%)						
SP 2004		1.9	2.5	2.5	2.2	2.4
SP 2005		2.4	1.7	1.8	2.4	2.5
<i>Difference¹⁾</i>		<i>0.5</i>	<i>-0.8</i>	<i>-0.7</i>	<i>0.2</i>	<i>0.1</i>
General government net lending (% of GDP)						
	EDP B.9					
SP 2004		-1.3	-1.9	-1.7	-0.8	0.0
SP 2005		-1.0	-1.9	-1.7	-0.8	0.0
<i>Difference¹⁾</i>		<i>0.3</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
General government gross debt (% of GDP)						
SP 2004		64.2	63.6	63.1	61.6	59.1
SP 2005		63.6	63.4	63.1	61.6	59.5
<i>Difference²⁾</i>		<i>-0.6</i>	<i>-0.2</i>	<i>0.0</i>	<i>0.0</i>	<i>0.4</i>

1) A positive sign denotes an improvement.

2) A positive sign denotes a deterioration.

Source: Statistics Austria, WIFO, Federal Ministry of Finance

The divergence of the debt ratio mainly stems from the fact, that possible stock-flow-adjustments were taken into account to a larger extent than in the previous update. Without these adjustments, an identical debt ratio would be reached in the year 2008.

4.2. Sensitivity of budgetary projections to different scenarios and assumptions

According to the Code of Conduct on the format and content of Stability and Convergence Programmes, member states should quantify economic risks in their programmes. The interest rate risk is explicitly mentioned in that context. In addition, the dependence of projected macroeconomic and budgetary outcomes shall be quantified with respect to those variables which strongly diverge from the common external assumptions. Against this background, the effects of various exogenous growth and price shocks on the macroeconomic and budgetary prospects have been analysed.

Table 6A. Economic growth and public finances in 3 scenarios

	2004	2005	2006	2007	2008
Scenario 1 - Permanent oil price shock and low growth of world economy					
GDP, value, in billions of €	237.0	246.20	255.40	265.30	274.90
GDP, volume, change in %	2.4	1.74	1.21	1.95	2.06
Growth differential		0.06	-0.58	-0.42	-0.41
General government net lending (% of GDP)	-1.0	-1.90	-1.90	-1.14	-0.64
General government net lending in billions of €		-4.60	-5.00	-3.00	-1.80
General government gross debt in billions of €	150.8	155.61	161.08	164.61	166.87
General government gross debt (% of GDP)	63.6	63.22	63.06	62.06	60.69
Scenario 2 - Low growth of world economy, low interest rates					
GDP, value, in billions of €	237.0	244.80	252.80	261.90	271.10
GDP, volume, change in %	2.4	1.47	1.41	2.00	2.12
Growth differential		-0.20	-0.40	-0.37	-0.36
General government net lending (% of GDP)	-1.0	-2.00	-2.00	-1.15	-0.62
General government net lending in billions of €		-4.90	-5.00	-3.00	-1.70
General government gross debt in billions of €	150.8	155.90	161.40	164.92	167.10
General government gross debt (% of GDP)	63.6	63.68	63.85	62.98	61.63
Scenario 3 - High growth of world economy, high interest rates					
GDP, value, in billions of €	237.0	245.80	255.80	267.00	278.70
GDP, volume, change in %	2.4	1.89	2.18	2.74	2.84
Growth differential		0.20	0.40	0.38	0.37
General government net lending (% of GDP)	-1.0	-1.80	-1.40	-0.24	0.63
General government net lending in billions of €		-4.40	-3.60	-0.60	1.80
General government gross debt in billions of €	150.8	155.44	159.57	160.72	159.46
General government gross debt (% of GDP)	63.6	63.23	62.38	60.19	57.22

Source: Statistics Austria, Federal Ministry of Finance

Scenario 1 in table 6A simulates a drastic increase in the price of imports, as is typical in the event of an oil price shock. This increase in prices leads to a similar increase in the level of prices on Austrian export markets and to a sustained slowdown in growth. The model simulations warrant the following analysis: In the first year of the permanent shock, net exports still deliver a small positive contribution to growth (0.06 PP of GDP). In year 2, weaker investment activity and lower private consumption show their effects, and overall growth is some 0.6 PP lower than in the baseline scenario. In such a worst case scenario of a sustained lower international growth performance, a balanced budget in nominal terms would not be attained by 2008.

In the short term, the biggest risk comes in the form of a fall in demand for Austrian goods and services in Austrian export markets, even if monetary policy is accommodative (scenario 2). Due to the absence of price effects, the relative price competitiveness cannot come to bear. On the other hand, higher than expected growth of the world economy could lead to a balanced budget by the year 2007 and a budget surplus in nominal terms by 2008 (scenario 3).

In the last couple of years, the Austrian economy exhibited a comparably low interest rate risk. More specifically, an increase of long term interest rates by 100 basis points results in growth being approximately 0.1 PP lower in the year of the interest rate shock. The far more decisive parameters for the Austrian economy are the growth of relevant export markets and changes to Austria's price competitiveness. The latter is mainly determined by 3 factors: the price of imports, price setting behaviour in the domestic economy, and the price level in Austrian export markets. The importance of these factors continues to increase with the degree of openness of the Austrian economy. The degree of openness (measured as the sum of exports and imports as a percentage of GDP) has increased from values below 70 in the years before the Internal Market to a value just below 100 in 2004. For the year 2008, a value of approximately 105 is expected.

5. Quality of public finances

In the last update of the programme three different long-term reform projects which contribute to improve the quality of public finances and aim to shift the spending structure from a backward to a forward looking orientation, were presented. In the following, progress made in the implementation of these reform projects is documented. This comprises the Health Reform Act 2005, the Administration Reform Act II and pension reform, following the taxonomy of the last update. Newly added is the reform of the federal budget law by means of the introduction of a medium-term (four years) budgetary framework starting in 2007.

5.1. Health Reform Act 2005

In the context of the Health Reform Act 2005 the following measures are planned for the years 2005 - 2008:

- Creation of a federal health agency and 9 health funds on the provincial level as instruments of a joint effort in planning and governance, and to coordinate the financing of the whole health sector. The key actors and financing bodies of the Austrian health sector will be represented in these institutions.
- Implementation of the *Austrian Structural Health Plan* providing a forward looking framework for the planning of supply of health services.
- Accomplishment of joint pilot projects for integrated planning, implementation and financing of the supply of specialists' services in the area of hospital out-patient treatment and medical practitioners.

In order to dampen cost dynamics, improve efficiency and cost-control in the health sector, the following measures, amounting to 300 Mio. € in expenditure cuts, are taken:

- Lower spending on administrative and non-patient-related costs
- Introduction of new forms of organisation in hospitals like day hospitals and week hospitals, as well as other comparable forms of service provisions
- Better coordination of individual hospitals and practitioners to avoid duplication
- Improve regional availability of practitioners

The financing of the additionally provided 300 Mio. € for the health sector will be accomplished by the following measures:

- Earmarked increase of the tobacco tax by 0,18 € per package for expenditures in the health sector
- Increase of health insurance contributions by 0.1 PP
- Increase of the maximum contribution base by 90 €
- Reduction in social security refunds for optical devices

5.2. Administrative Reform II

An integral part of the fiscal revenue sharing scheme covering the years 2005-2008 has been the creation of a working group at the highest political level, which, building upon the work of the Austrian Constitutional Convention, should propose measures how to take forward the ongoing Administrative Reform. Thus, a substantial contribution to the improvement of the quality of public finances and to the attainment of a balanced general government budget shall be made. This working group, comprising federal, provincial and municipal representatives, started work in March 2005. On 15 November 2005, representatives from the different levels of government agreed on the implementation of the following administrative reform measures:

- To slow down the cost dynamics at all levels of government via the setting of specific spending targets. Thus, between July 2005 and the year 2010, spending is to be reduced by 1,886bn €. These savings include a reduction in personnel by 15,667 full time equivalents. The objectives are allocated to the different levels of government in the following manner:

Federal level: 700m €, 6,240 full time equivalents

State level: 844m €, 5,670 full time equivalents

Local level: 342m €, 3,757 full time equivalents

- Arrangements to optimize the school administration with a view to improve the quality in education. These are targeted at higher flexibility in the definition of schooling districts and a merging of administrative functions of small schools with the objective to preserve small school sites, especially in the countryside. The administrative structures shall be simplified markedly.
- Measures to save administrative expenses in the health sector and to slow down the cost dynamics in the hospital sector (among others, creation of joint purchasing competence centres, promotion of common IT-solutions).
- Standardisation of personnel data at different levels of government as a basis for effective personnel management to arrive at an internationally comparable benchmarking process.
- Partnerships between administrative bodies: creation of synergies through the extension of partnerships between administrations and through an enhanced cooperation between provinces and municipalities.
- E-Government: joint strategies how to proceed in this context, with the objective of improving the cooperation between different levels of government in the area of e-government and thereby promote user friendly solutions and the realisation of synergies between administrative bodies.
- Amendment to the law on the use of water: actions to streamline administrative procedures; freed up resources, personnel and material, shall be redirected towards the implementation of the water framework directive.
- Public procurement: create synergies by allowing public companies at the state and local levels to use the federal procurement agency (Bundesbeschaffung GmbH).

5.3. Pension reforms

Measures taken in the Pension Reform 2003 are already slowing pension expenditures in the social security pension system. Benefits were not cut across the board, rather they decreased in some, but increased in other areas of the pension system.

On January 1st 2005, in the context of the Pension Reform 2004, the *law on the harmonization of the pension systems* became effective. Thus, a unified pension system for all active persons was established. The creation of individual pension accounts for everyone is aimed at securing a modern and equitable pension system for the future.

The Reform 2004

- does *not* apply to insured persons who are at least 50 years old. For this group only a modification of the Reform 2003 applies (pension corridor, "hard labour"-exemption, temporary lowering of the 10% cap on losses to 5% with a gradual increase by 0,25 pp per year to 10% in 2024).
- does apply to insured persons up to the age of 50 years who have already acquired insurance times; the benefits are evaluated in a system of parallel accounting.
- does apply to persons, who on January 1st, 2005, had not yet established any claims to pension benefits at all. For this group of persons, only the following rules apply:
 - Formula 45/65/80: After 45 contribution years at a retirement age of 65 a public pension amounting to 80% of average lifetime earnings shall be attained.
 - Every insured person will be provided with a transparent pension account displaying both contributions paid and claims to pensions benefits acquired so far.
 - These claims, once they show up on the pension account, cannot be reduced any more.
 - Established claims are scaled up according to the average yearly increase of the contribution base.
 - Accrual rates are a uniform 1.78 pp.
 - Established pension claims are adjusted according to the change in the consumer price index starting in 2006, with high pensions being temporarily treated in a separate manner.
 - The joint employer-employee contribution rate is a uniform 22.8%. For farmers and self-employed, the difference is borne by the federal government.
 - There is only one maximum and one minimum contribution base for all insured persons.
 - Insurance times instead of replacement times: All periods which used to be considered as replacement times are transformed into insurance times through the payment of insurance contributions. Child care times, military/civil service or hospice leaves will become effective with a contribution base of 1,350 €. For childcare times, one half of the payments will come from a fund for the financing of family transfers and one half will be paid out of the general budget until 2009. From 2010 on, that ratio will be 75 to 25.
 - As a rule, the retirement age will be 65 years. The start of pension eligibility lies within a corridor between 62 and 68 years. Up to the age of 68 a bonus can be acquired. Within this corridor, premiums and discounts can be acquired, amounting to 4.2% per year of late or early retirement respectively.

- Sustainability factor: To ensure financial sustainability, a sustainability factor is introduced. Until 2050, it is based on the path of period-dependent life expectancies of Statistic Austria's medium scenario until the age of 65. Regular evaluations will take place. In case of divergences from the medium scenario, appropriate automatic adjustments of the contribution rate, accrual rate, retirement age, pension adjustment factor and contributions out of the public budget come into effect.
- "Hard labour": A regulation for hard labour is currently intensively discussed with social partners. It is expected to come into effect on January 1st, 2007. Parallel to this rule, there are additional rules for those with long insurance times.

The Austrian government has to report to the parliament every three years on the functioning and financial sustainability of the system. In its recommendations, it has to make sure that the necessary assumptions for attaining the benefit targets (i.e. participation rates, productivity) are properly taken into account.

The pension reforms of the years 2000, 2003 and 2004 have reduced spending by an cumulative 11bn € in the period 2000-2006 compared to a scenario, where no reforms had taken place.

5.4. Reform of budgeting rules

The basis for a reform of budgeting rules was established by a group of experts which comprised representatives of all four political parties in the Austrian parliament. They were assisted in technical matters by the Federal Ministry of Finance, the Austrian Court of Audit and the Judicial Service of the Federal Chancellery.

The work was guided by international examples of best practice, by the recommendations of the International Monetary Fund and the OECD. The intention is to create a set of budgeting rules for the 21st century, that represents international best practice, combining well established instruments used abroad with the specifics of the Austrian administrative culture.

In a first step, a draft constitutional amendment, implementing the basis for the new budgetary framework and taking into account the main goals of Austrian budgetary policy (overall economic equilibrium, sustainability of public finances, effective gender balance), has been prepared. The implementation of the reform necessitates additional legal steps (non-constitutional law), which still have to be elaborated.

The 4 year budgetary framework

A budgetary framework covering 4 years will allow a medium term planning of budgetary expenditures. It applies to the expenditure side of the budget and increases substantially the predictability of the budget for all agents involved. Its respective budgetary priorities are not fixed in the constitutional laws, but display political priorities of the respective governments.

The budgetary framework is a federal law and as such can be changed by federal law. It is planned to be rolled forward by one year every spring. Medium term expenditure frameworks of this kind constitute international best practice.

The structure of the budgetary framework at the aggregate level displays categories defining expenditure ceilings for individual policy areas. Currently, the following categories are planned:

1. Justice and Security
2. Labour, Social Security, Health and Family
3. Education, Research, Culture and the Arts
4. Economy, Infrastructure and Environment
5. Interest and cash holdings

These categories shall be disaggregated further in order to arrive at envelopes for individual ministries. There is a distinction between fixed and flexible expenditure ceilings. Flexible expenditure ceilings apply in those areas, that are strongly dependent on the business cycle (e.g. labour market allocations, pensions, family transfers). The budgetary framework is completed by those elements that are necessary to display various necessary budgetary key figures (net lending, gross debt). The revenue side is estimated.

The budgetary framework is to enter into force on January 1st, 2007.

In a second step, that is substantially more time consuming, four major principles of budgeting shall be implemented.

1. *Performance budgeting*: Budgetary expenditures are linked with objective goals concerning their function and impact. This lays the foundations for a shift away from the input orientated budgeting that has dominated until now. As is the case in international best practice, there is a

direct link between responsibility for outcomes and resources. To this end, global budgetary envelopes are used. The relevant controlling will be taken care of by individual ministries.

2. *Transparency*: This principle encompasses the current principles of transparency of the budget, the completeness and exhaustiveness of the budget, unequivocal assignments of responsibility at every stage of the budgetary process, as well as timely information on the current state of the execution of the budget. The principle demands, that budgetary goals can be clearly identified and that circumstances and results of the budgetary process are documented in a transparent manner.

3. *Efficiency*: This central principle applies to all forms of government activity with a focus on the spending of budgetary resources (effective, economical, and optimal use of resources). A central feature of this process will be an increased flexibility of budgeting authorities in their implementation of policy objectives. The extremely encouraging lessons from the use of the *flexibility clause* will be incorporated in this new set of budgeting rules.

4. *Accurate representation of the financial situation of the federal government*: This principle asks for sophisticated systems of budgeting, accounting and reporting. It encompasses both the principle of truthful budgeting and of gross budgeting. The constitutional amendment would allow the application of commercial principles alongside the money-flow-view of cameralistics.

The budgeting principles shall enter into force on January 1st, 2011.

Once the new set of budgeting rules will be fully implemented, it could reduce expenditures by as much as 5% of the federal budgetary expenditures in the long run.

6. Sustainability of public finances

In 2002, the ECOFIN council gave a mandate to the Economic Policy Committee to calculate new spending projections for health and pension expenditures on the basis of the demographic projections of EUROSTAT. The central results of these new projections of pension expenditures are shown below (those for health, long term care and education were not available when this update was compiled).

Total public expenditures on pensions are projected to increase from 14.3% of GDP in 2004 to a maximum of 15.0% of GDP in the year 2032, after which they decrease to 13.1% of GDP in the year 2050. Public expenditures on social security pensions are projected to increase from a current figure of 10.5% of GDP to a maximum figure of 12.5% of GDP in the year 2035. This increase is mainly driven by the growth in the number of pensions, i.e. it is mainly due to a less favourable demographic developments.

Table 7. Long-term sustainability of public finances

% of GDP	2005	2010	2020	2030	2050
Pension expenditure	14.2	13.7	13.7	15.0	13.1
<i>of which: Social security pension</i>	<i>10.5</i>	<i>10.3</i>	<i>10.7</i>	<i>12.2</i>	<i>11.9</i>
<i>of which: Public pension</i>	<i>3.6</i>	<i>3.3</i>	<i>3.1</i>	<i>2.8</i>	<i>1.2</i>
Old-age and early pensions	11.0	10.8	11.2	12.4	11.1
Others	2.2	1.9	1.6	1.3	0.9
Total pension revenue	8.9	9.0	9.0	8.9	8.7
<i>of which: pensions contributions</i>	<i>8.2</i>	<i>8.3</i>	<i>8.2</i>	<i>8.0</i>	<i>7.9</i>
Assumptions ¹⁾					
Labour productivity (%)	1.5	1.8	1.8	1.7	1.7
Real GDP (%)	1.9	1.5	1.5	1.4	1.4
Participation rates males (aged 15-64)	77.1	78.9	80.6	80.2	80.5
Participation rates females (aged 15-64)	63.9	67.8	70.7	70.9	71.8
Total participation rates (aged 15-64)	70.5	73.3	75.6	75.6	76.2
Unemployment rate	3.9	3.4	3.4	3.4	3.4
Dependency ratio (65+/15-64)	23.6	26.3	30.3	40.8	53.2

1) Due to the modelling assumptions in the long run projections exercise, figures for the year 2005 may differ substantially from those in the current macroeconomic outlook.

There is no final data available regarding health care, long term care and education

NB: figures may not sum up due to rounding errors.

Source: Federal Ministry for Social Security, Generations and Consumer Protection, Federal Ministry of Finance

A considerable dampening effect on pension expenditures comes from pension reforms. Spending on pensions of civil servants (federal, state, local levels and social security) is continuously decreasing from 3.8% of GDP in the year 2004 to a figure of 1.2% of GDP in the year 2050. This decrease is due to a growing number of civil servants being insured in the social security system and due to a lower replacement rate for newly retiring civil servants. Pension revenues roughly stabilize around 9% of GDP until 2020, after which they fall at a moderate pace to 8.7% of GDP until the year 2050. According to these projections, the Austrian pensions system is sustainable in the long run.

7. Horizontal measures influencing public finances

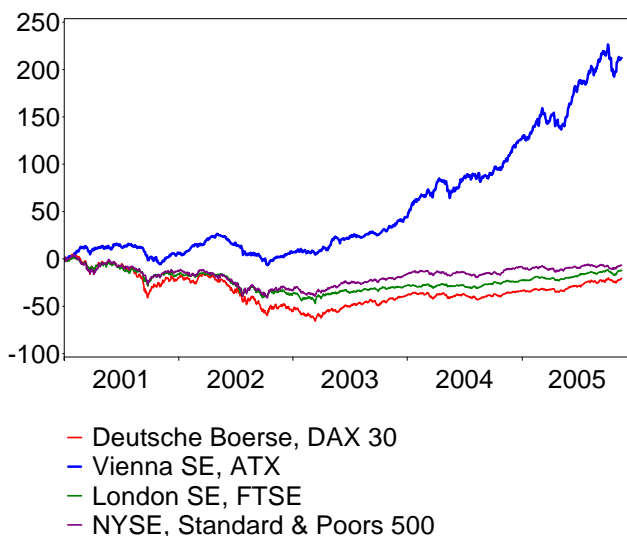
7.1. Capital markets

The strengthening of the second and the third pillar of the pension system, the privatisation of formerly state owned enterprises, and improvements in the legal framework and the market infrastructure have created substantial positive impulses for Vienna as a financial market place. The excellent performance of the ATX (Austrian Traded Index), which has outperformed the most important international equity indices since 2001, as well as a significant increase of market turnover and market capitalisation reflect this successful development (figures 8 and 9). As far as capital markets are concerned, the focal point for the next year will be on the transposition of the capital adequacy rules for banks (Basle II) into national law. Flanking measures for the non-financial corporate sector shall mitigate possible negative impacts of the modified capital requirement regulation. A business model designed to support the equity capital structure of small and medium size enterprises (Mittelstandsfinanzierungsgesellschaft) shall be aligned with EU state aid regulation.

One important further aspect in this context is good corporate governance. Further development of the Corporate Governance Codex in the areas of transparency and strengthening of the independence of the supervisory board shall add to a continuously improving investor confidence. The current Codex was welcomed by the market and is now used by all corporations listed in the Prime Market. Measures planned in the context of the Action Plan for Financial Services on a European scale have, to a vast extent, been transposed into national law already (the latest being the Prospectus Directive, the Market Abuse Directive, and the Financial Conglomerates Directive). In the near future, the focus will be on the implementation of the principles that were set up to safeguard their uniform application and to enhance cooperation between member states. It will be further examined how cross-border access to financial services and portfolio management for retail clients can be strengthened.

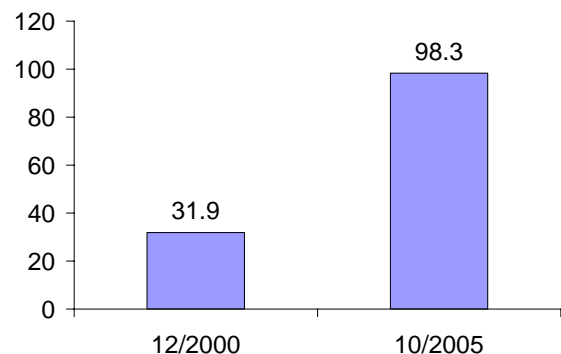
Deeper financial markets have a positive impact on the financing structure of the companies and thus on economic growth and therefore constitute a crucial element of the Austrian economic policy strategy.

Figure 8: Performance of the financial markets
Performance of equity indices since 2001 in %



Source: EcoWin

Figure 9: Market Capitalisation
in billions of €



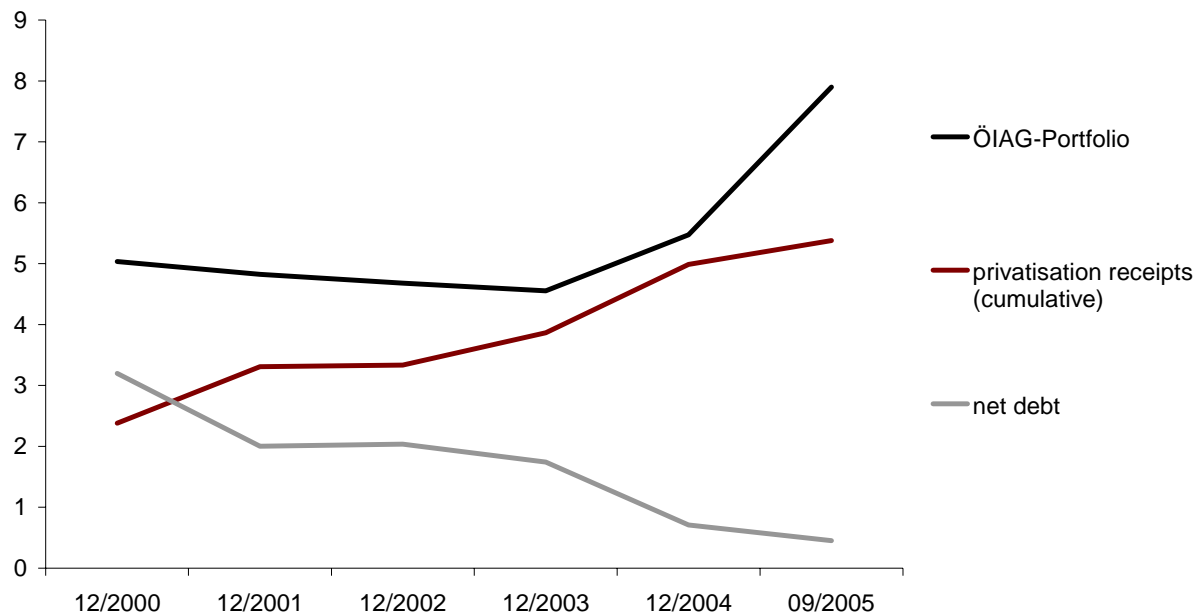
Source: Vienna Stock Exchange

7.2. Privatisation

The Austrian Industry Holding ÖIAG (Österreichische Industrieholding AG; it is the holding and privatisation agency of the Republic of Austria) has almost fully completed the privatisation programme of the Austrian federal government that had been envisaged for this parliamentary period. The objectives defined in the government mandate have been fully met:

- The debt of the formerly state owned industry has been repaid
- The market value of the holdings of the ÖIAG has clearly increased
- The net asset value of the ÖIAG has been multiplied
- Austria has been strengthened as a business location in a sustained manner

Figure 10: ÖIAG portfolio development 2000 to 2005
in billions of €



Source: ÖIAG

Revenues stemming from privatisation amounted to 1.2bn € in 2004. They were fully used for debt redemption. Back in 1999, the net debt level of the ÖIAG was 6.3bn €, on 30 September 2005 it was reduced to 455m €. The net debt of the ÖIAG can be viewed as almost completely liquidated during 2005, if one includes the outstanding convertible bonds of Austria Telekom in the calculation. Starting from 2000, cumulated revenues stemming from privatisation amount to 5.4bn €. At the same time, the asset value of the ÖIAG portfolio was raised to 7.9bn €. Today, the remaining portfolio of the ÖIAG consists of stakes in Austrian Airlines AG, OMV AG and Telekom Austria AG as well as in Austrian Post AG and GKB Bergbau GmbH, of which the latter two are non-listed companies.