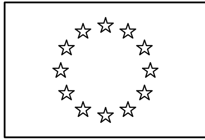
EN



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.10.2009
SEC(2009) 1267 final

REPORT FROM THE COMMISSION

Austria

Report prepared in accordance with Article 104(3) of the Treaty

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the budget balance as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn has brought about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan foresaw that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to prepare a report such as the present one whenever an actual or planned deficit of a Member State exceeds the 3% of GDP reference value. This report, which represents the first step in the "excessive deficit procedure" (EDP), analyses the reasons for the breach of the reference value with due regard to the economic background and all other relevant factors. The amendments to the Stability and Growth Pact in 2005 aimed specifically at ensuring that in particular the economic and budgetary background was fully taken into account in all steps in the EDP. This means for instance that, if an "excessive deficit" is deemed to exist, adequate consideration needs to be given to the economic background and outlook when making recommendations on the pace of the correction. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

2. LEGAL BACKGROUND

This report, which assesses recent and current budgetary developments in Austria and reviews the short- and medium-term prospects in the light of overall economic conditions and policy action taken by the government, is prepared according to Article 104(3) of the Treaty.

Article 104 of the Treaty includes the provisions for an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1] , which is part of the Stability and Growth Pact. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product GDP)

[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of Stability and Convergence Programmes", endorsed by the ECOFIN Council of 11 October 2005, available at http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

According to the April 2009 update of the stability programme and data notified by the Austrian authorities in April 2009[2], the general government deficit is planned to reach 3.5% of GDP in 2009, thus exceeding the 3% of GDP reference value, while general government gross debt would amount to 68.5% of GDP, above the 60% of GDP reference value. The downward trend in the debt ratio observed for the period 2000 to 2007 was reversed already in 2008, reflecting the financial sector support measures, and is projected to rise further in response to the financial crisis and the recession.

Table 1: General government deficit and debt [a]

	2004	2005	2006	2007	2008	2009		2010	
						COM	April 2009 EDP Notification	COM	April 2009 EDP Notification
General government balance	-4.4	-1.6	-1.6	-0.5	-0.4	-4.2	-3.5	-5.3	n.a.
General government gross debt	64.8	63.7	62.0	59.4	62.5	70.4	68.5	75.2	n.a.

Note:
[a] In percent of GDP.
Source: Eurostat, Commission services' spring 2009 forecast and the April 2009 EDP notification.

The planned figures in the notification for the deficit and debt in 2009 provide *prima facie* evidence on the existence of a planned excessive deficit in Austria in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore decided to initiate the excessive deficit procedure for Austria with the adoption of this report. Section 3 of the report examines the deficit criterion and Section 4 the debt criterion. Section 5 deals with public investment and other relevant factors. This report takes into account the Commission services' spring 2009 forecast, released on 4 May, and their evaluation of subsequent developments.

3. DEFICIT CRITERION

According to the April 2009 EDP notification of the Austrian authorities, the general government deficit is planned to reach 3.5% of GDP in 2009. This projection was based on

[2] According to Council Regulation (EC) No 479/2009 (previously Council Regulation (EC) No 3605/93, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Austria can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

the assumption of GDP growth of -2.2% in 2009. On the basis of a significantly worse economic outlook (GDP growth of -4.0%) the Commission services' 2009 spring forecast projects the deficit to reach 4.2% in 2009. The government deficit in 2009 would therefore not remain close to the Treaty reference value.

The planned excess over the 3% of GDP reference value is exceptional. In particular, it results from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. According to the Commission services' 2009 spring forecast, real GDP in Austria is projected to contract sharply in the year 2009 at -4%. The recession reflects the abrupt decline in private investment and foreign trade in the export-oriented manufacturing sector as a consequence of the financial crisis and the global slowdown, in particular the much lower growth prospects of the main trading partners (Euro area, Central and Eastern Europe).

The excess over the 3% of GDP reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. The Commission services' spring 2009 forecast projects that, taking into account the measures adopted in the current year for the budget for 2010, the deficit would widen to 5.3% of GDP in 2010 on a no-policy change[3] basis. According to the April 2009 update to the stability programme, the deficit is targeted to increase to 4.7% of GDP in 2010 and to remain at that level until 2012 before narrowing to -3.9% of GDP in 2013, based however on yet to be specified consolidation measures.

Table 2: Macroeconomic and budgetary developments [a]

	2004	**2005**	**2006**	**2007**	**2008**	**2009**		**2010**	
						COM	**April 2009 SP**	**COM**	**April 2009 SP**
Real GDP (% change)	2.5	2.9	3.4	3.1	1.8	-4.0	-2.2	-0.1	0.5
Potential GDP (% change)	2.1	1.9	1.7	1.6	1.5	1.0	1.3	1.1	1.3
Output gap (% of potential GDP)	-1.4	-0.5	1.2	2.7	2.9	-2.2	-0.9	-3.3	-1.7
General government balance	-4.4	-1.6	-1.6	-0.5	-0.4	-4.2	-3.5	-5.3	-4.7
Primary balance	-1.5	1.3	1.1	2.2	2.1	-1.1	-0.6	-2.1	-1.7
One-off and other temporary measures	-3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government gross fixed capital formation	1.1	1.1	1.1	1.0	1.0	1.1	1.1	1.1	1.0
Cyclically-adjusted balance	-3.7	-1.4	-2.2	-1.8	-1.8	-3.2	-3.1	-3.8	-3.9
Cyclically-adjusted primary balance	-0.9	1.5	0.6	1.0	0.8	-0.1	-0.2	-0.6	-0.9
Structural balance [b]	-0.4	-1.4	-2.2	-1.8	-1.8	-3.2	-3.1	-3.8	-3.9
Structural primary balance	2.4	1.5	0.6	1.0	0.8	-0.1	-0.2	-0.6	-0.9

Notes:
[a] In percent of GDP unless specified otherwise.
[b] Cyclically-adjusted balance excluding one-off and other temporary measures.
Source: *Eurostat, Commission services' spring 2009 forecast, the April 2009 EDP notification and the April 2009 stability programme update.*

In sum, the deficit in 2009 is not expected to remain close to the 3% of GDP reference value and although the excess over the reference value can be regarded as exceptional it is not temporary in the sense of the Treaty and the Stability and Growth Pact. This analysis suggests that the deficit criterion in the Treaty is not fulfilled.

[3] The no-policy change forecast takes into account the (partial) withdrawal of measures of extraordinary nature linked to the crisis.

4. DEBT CRITERION

Up from 62.5% of GDP in 2008, the general government gross debt in the April 2009 EDP notification is planned to increase to 68.5% of GDP for 2009, above the 60% of GDP Treaty reference value. This reverses the downward path from 2000 to 2007, when the debt-to-GDP ratio dipped below the 60% reference value for the first time since 1992, thanks to cyclical developments but also reducing expenditure-measures.

The large increase in the debt level in 2008 and 2009 is mostly the result of a sizeable stock-flow adjustment (amounting respectively to 5.1% and 1.9% of GDP) linked to the financial market stabilisation package (see Section 5.4 for more details). From 2009 on, strong contributions are projected to come inter alia from a growing primary deficit in connection with the 2009 tax reform and the fiscal stimulus package in response to a worsening of economic prospects. In the past, "snowball" effects had a relatively low, usually debt-reducing impact. Their impact has now turned debt-increasing, on the back of increasing interest expenditure and falling nominal GDP, which together should contribute significantly to the rise in the debt ratio especially in 2009. In 2010, the debt ratio is expected to rise further to 75¼% of GDP.

In view of these trends, the debt ratio cannot be considered as "sufficiently diminishing and approaching the reference value at a satisfactory pace" in the sense of the Treaty and the Stability and Growth Pact, suggesting that the debt criterion stipulated in Article 104(3) of the Treaty is not fulfilled.

Table 3: Debt dynamics [a]

	2004	2005	2006	2007	2008	2009		2010	
						COM	April 2009 SP	COM	April 2009 SP
Government gross debt ratio	64.8	63.7	62.0	59.4	62.5	70.4	68.5	75.2	73.0
Change in debt ratio [b] (1 = 2+3+4)	-0.7	-1.1	-1.7	-2.6	3.1	7.9	6.0	4.8	4.5
Contributions:									
• Primary balance (2)	1.5	-1.3	-1.1	-2.2	-2.1	1.1	0.6	2.1	1.7
• "Snowball" effect (3)	0.2	-0.2	-0.4	-0.3	0.2	4.7	3.4	2.6	2.1
of which:									
Interest expenditure	*2.9*	*2.9*	*2.7*	*2.7*	*2.5*	*3.0*	*2.9*	*3.2*	*3.0*
Real GDP growth	*-1.6*	*-1.8*	*-2.0*	*-1.8*	*-1.0*	*2.6*	*1.4*	*0.1*	*-0.3*
Inflation (GDP deflator)	*-1.0*	*-1.3*	*-1.1*	*-1.3*	*-1.4*	*-0.9*	*-0.9*	*-0.7*	*-0.6*
• Stock-flow adjustment (4)	-2.4	0.5	-0.1	0.0	5.1	1.9	2.0	0.1	0.7

Notes:
[a] In percent of GDP.
[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; *D, PD, Y* and *SF* are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.
Source: *Eurostat, Commission services' spring 2009 forecast, the April 2009 EDP notification and the April 2009 stability programme update.*

5. RELEVANT FACTORS

Article 104(3) of the Treaty provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration.

In view of the above provisions, the following four subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); (3) other factors put forward by the Member State and (4) other factors considered relevant by the Commission.

5.1. Medium-term economic position

Cyclical conditions and potential growth. The Commission services' spring 2009 forecast projects a contraction of Austrian GDP by 4.0% in 2009, driven by the collapse of external demand. In 2010, a moderate recovery, with real GDP growth stagnating at -0.1%, would be induced by a rebound in world trade and the positive effects of the fiscal stimulus measures. At the end of 2008 cyclical conditions showed a sharp reversal of the positive output gap

observed since 2006, with the output gap turning strongly negative in 2009 and 2010. In 2009-2010, Austria is thus expected to be in "bad economic times". According to Commission services' calculations, potential output growth was below its long-run average of 2¼% in the last 3 years, and is projected to abate further to 1% in 2009 and 2010, reflecting a decrease in labour contribution and lower capital accumulation as a result of a drop in investment.

Recent structural reforms. At microeconomic policy level, Austria's National Reform Programme 2008-2010 (NRP) outlines as a priority the strengthening of knowledge and innovation in order to boost Austria's attractiveness as business location for both investors and the labour force. Cornerstones of the national reform are enhanced efforts in R&D, building of new infrastructure, fostering of SMEs, as well as the promotion of environmental technologies and efficient resource management. According to the NRP, Austria's R&D ratio amounted to 2.6% of GDP in 2008 compared with 1.9% in 2000. This is in line with the Lisbon Strategy for Growth and Jobs' objective of raising R&D investment to 3% of GDP by 2010, thereby ensuring Austria's transition towards a knowledge-based economy.

5.2. Medium-term budgetary position

Structural deficit and fiscal consolidation in good times. Between 2006-2008 Austria was clearly in economic good times, as assessed in terms of strong GDP growth and a positive output gap. However, the structural balance worsened markedly by 0.8 pp in 2006 to -2.2% of GDP and improved only slightly to -1.8% in 2007 and 2008. This development was on the one hand due to better than expected fiscal revenues, which were on the other hand largely off-set by a heavier interest burden, higher spending on subsidies and policy measures to preserve households' purchasing power in the face of rising inflation. Insofar, Austria did not take advantage of the favourable economic situation to consolidate public finances. Austria's medium-term objective (MTO) is to achieve a balanced budget, which is part of a comprehensive three-pillar budgetary strategy including also public investment schemes and structural reform in public administration. Driven by automatic stabilizers and the fiscal stimulus measures in response to the crisis, the Commission services' 2009 spring forecast projects a general government deficit of 4.2% in 2009, widening further to 5.3% of GDP in 2010. With the structural deficit[4] projected at 3.2% of GDP in 2009 and rising to around 4% from 2010, it is expected that the MTO will not be achieved over the whole the programme period. Accordingly, the fiscal policy stance is expansionary in 2009 and 2010.

Public investment. Government investment as a share of GDP fell by 2.1 percentage points between 1995 and 2003 to 1.1% of GDP and has been stable since then. This development reflects mainly the outsourcing of public infrastructure and health care activities to state-owned enterprises. Over the same period the deficit ratio was reduced by 1.4 percentage points.

For the period 2003 to 2006 the general government deficit ratio has exceeded the government investment-to-GDP ratio, whereas for 2007 and 2008 public investment was above the general government deficit. According to the Commission services' spring 2009 forecast, the general government deficit ratio is projected to exceed the public investment ratio by 3 percentage points in 2009 and 4¼ percentage points in 2010. In structural terms, the

[4] The cyclically adjusted balance net of one-off and other temporary measures, recalculated by Commission services on the basis of the information in the Programme using the commonly agreed methodology.

government deficit will be higher by 2 and 2¾ percentage points than public investment in 2009 and 2010, respectively.

Quality of public finances. General government expenditure has fallen from over 55% of GDP in the mid-1990s to 48.7% in 2008, still slightly above euro area average. Driven by the measures in response to the economic and financial crisis and additional expenditure due to automatic stabilisers, the expenditure-to-GDP ratio will increase by 2.6 percentage points until 2010. Despite the overall sound quality of public finances and fiscal rules, there is still room for improvement of Austria's institutional budgetary framework. Austria's federal fiscal relations – governed by the Fiscal Equalisation Act ("Finanzausgleichsgesetz") 2008-2013 and the Domestic Stability Pact 2008 – are rather complex due to overlapping responsibilities, co-administration and co-financing at all three levels of government. Consequently, there is scope for efficiency gains in several areas of public spending, in particular in health care and education. In this context, the 2009 stability programme update refers to the formation of working groups on further reforms of the federal fiscal stability arrangements as well as health and elderly care system. However, tangible proposals are not expected before 2011. To contain spending, the government embarked on a reform of the budgetary framework law (federal level) comprising a new multi-annual expenditure framework with fixed ceilings (for about 80% of total expenditures) set for four consecutive years on a rolling basis (Federal Budgetary Framework Act – "Bundesfinanzrahmengesetz"). It is expected to prevent pro-cyclical spending and to enhance the effectiveness of the automatic stabilisers. Starting as of 2013, the reform also foresees the introduction of output-based budgeting ("performance budgeting") and the modernisation of the accounting system of the public administration.

Long-term sustainability of public finances. In its opinion of 7 July 2009 on update of the April 2009 stability programme, the Council assessed the long-term sustainability of Austria's public finances. In particular, the Council was of the opinion that the long-term budgetary impact of ageing in Austria is lower than the EU average, with pension expenditure projected to decrease as a share of GDP over the long-term. The budgetary position in 2008, as estimated in the Programme, which is worse than the starting position of the previous programme, compounds the budgetary impact of population ageing. Moreover, the current level of gross debt is above the Treaty reference value. The risks from the above mentioned financial sector stabilisation schemes could have a potential negative impact on the long-term sustainability of public finances, primarily via their impact on government debt, although some of the cost of the government support could be recouped in the future. Achieving high primary surpluses over the medium term would contribute to reducing risks to the sustainability of public finances, which are currently at a medium level[5].

5.3. Other factors put forward by the Member State

The authorities of Austria have not presented any relevant factors as they can do according to Article 2(3) of Council Regulation (EC) No 1467/97.

5.4. Other factors considered relevant by the Commission

Planned public finance developments in Austria are also influenced by the following factors in the area of budgetary institutions and procedures.

---

[5] Since the submission of the stability programme, risks to long-term sustainability may have changed in view of the worsened economic and budgetary situation. The new assessment will be published in the upcoming report on long-term sustainability of public finances in the European Union.

To stabilize financial markets, the Austrian authorities have adopted several measures, including guarantees of bank deposits held by individual persons (unlimited until the end of 2009, thereafter up to €100 000; for deposits held by small and medium sized enterprises the upper ceiling is €50 000). The Austrian government provided guarantees up to €65 billion (24% of GDP) for interbank loans, bond issues by the newly-funded Austrian Clearing Bank (OeCAG) and for commercial paper issues by commercial banks. Finally, the government has allocated up to €15 billion (5½% of GDP) for capital injections and asset relief measures to financial institutions. By end of September €1.2 billion of asset relief and around €4.9 billion of capital injections were effectively called. In addition guarantees for loans to enterprises ("Unternehmensliquiditaetsstaerkungsgesetz") are provided up to €10 billion (3½% of GDP), but so far no final decisions were taken.

In accordance with the European Economic Recovery Plan (EERP), the Austrian government has taken sizeable fiscal counter-action. Two economic recovery programmes, income tax cuts and two labour market support package were introduced with a focus on income support, reducing lay-offs and improving access to training, sustaining investment and private access to finance. Support to credit-constrained enterprises comes mainly in off-budget form as guarantees and subsidised loans. To support the automotive industry, a premium is offered for scrapping old cars on the purchase of new ones. Recovery programmes I and II announced the front-loading of infrastructure projects of state-owned enterprises to stimulate construction activity. In addition to such discretionary measures, automatic stabilisers will be allowed to operate.

In the Council Opinion on the April 2009 update of the Stability Programme fiscal measures were considered as appropriately expansionary in 2009 and 2010 albeit only partly in line with the general principles of the EERP since the bulk of them is of permanent nature. Hence a credible and sound strategy is needed for budgetary consolidation to resume as soon as the crisis abates. Moreover, given the markedly benign assumptions for GDP in 2009 and beyond, the authorities' budgetary projections were considered subject to substantial downside risks. While the direct budgetary implications of the support programmes for enterprises and commercial banks were estimated to be limited, guarantees - if called - would lead to a further deterioration of public finances.

Therefore the Council invited Austria to (i) implement the 2009 and 2010 fiscal policy as planned including the stimulus measures in line with the EERP, and within the framework of the SGP to reverse the fiscal stimulus in order to support significant budgetary consolidation towards the MTO, starting in 2011 at the latest, (ii) to substantiate the measures deemed necessary to achieve a general government deficit below the 3% of GDP reference value and (iii) to further improve the budgetary framework to strengthen fiscal discipline at all levels of government through enhanced transparency and accountability notably by aligning legislative, administrative and financing responsibilities between the different levels of government.

6. CONCLUSIONS

In the April 2009 EDP notification the planned general government deficit in Austria is notified to reach 3.5% of GDP in 2009. However, the projections of the Commission services' suggest that the 2009 deficit will be significantly higher than that. The deficit in 2009 is therefore not expected to remain close to the Treaty reference value. The planned excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the

Stability and Growth Pact. However, it cannot be considered temporary. This suggests that the deficit criterion in the Treaty is not fulfilled.

General government gross debt is above the 60% of GDP reference value since 2008 and is notified to reach 68.5% of GDP in 2009. The debt ratio can not be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact. This suggests that the debt criterion in the Treaty is not fulfilled.

In line with the Treaty, this report has also examined “relevant factors”, which - according to the Stability and Growth Pact - can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the twin condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. Considered on their own merit, the relevant factors in the current case present a mixed picture.

The existence of a severe economic downturn, with public finance implications, increases the need to undertake enhanced surveillance under the EDP.