EUROPEAN COMMISSION

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AUSTRIA - Commission assessment in relation to the Commission recommendation for a Council decision and recommendation under Articles 104.6 and 104.7 of the Treaty[1]

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 deficit 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 brings 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 explicated that the stimulus should be timely, targeted and temporary and 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[2], although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. 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, and thereby ensuring long-term sustainability of public finances.

[1] Excerpt from the explanatory memorandum of the Commission recommendation for a Council decision and recommendation under Articles 104(6) and 104(7) adopted by the Commission on 11.11.2009

[2] See the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release N° 103/2009.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 104 of the Treaty lays down 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"[3], 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) 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".

On the basis of the data notified by the Austrian authorities in April 2009[4] and taking into account the Commission services' spring 2009 forecast, the Commission adopted a report under Article 104(3) for Austria on 7 October 2009[5].

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 October 2009.

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

According to data notified by the Austrian authorities in April 2009, the general government deficit in Austria was planned, to reach 3.5% of GDP in 2009 on the assumption of GDP contracting by 2.2%, thus exceeding the 3% of GDP reference value. On the basis of a significantly worse economic outlook with GDP falling by 4%, the Commission services' 2009 spring forecast projected the government deficit to reach 4.2% in 2009. The Commission report under Article 104(3) considered that the planned deficit was not close to the 3% of GDP reference value but that the planned excess over the reference value could be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact,

[3] OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on 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/other_pages/other_pages12638_en.htm.

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

[5] All EDP-related documents for Austria can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

on the basis of the information available at the time of the report. Furthermore, the planned excess over the reference value could not be considered temporary.

According to more recent data notified by the Austrian authorities in October 2009, the general government deficit in Austria is planned to reach 3.9% of GDP in 2009, thus remaining above and not close to the 3% of GDP reference value. Based on the Commission services' autumn 2009 forecast, the planned excess over the reference value continues to qualify as exceptional within the meaning of the Treaty and the Stability and Growth Pact. 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 autumn forecast, real GDP in Austria is projected to contract sharply in the year 2009 by -3.7% compared to growth of 2% in 2008. 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). Furthermore, the planned excess over the reference value cannot be considered temporary. According to the Commission services' autumn 2009 forecast taking into account the fiscal measures adopted in the current year, the deficit would widen to 5.5% in 2010 (taking into account the fiscal measures adopted in the current year) and 5.3% of GDP in 2011 on a no-policy change assumption. This assumption takes into account that, according to government plans, a large part of the measures of extraordinary nature linked to the crisis in line with the EERP will be maintained in 2010 and 2011. Benefitting from a close to balance budgetary position in 2008, Austria adopted appropriate additional fiscal stimulus measures reaching 1½% of GDP in 2009 and ½% of GDP in 2010. The major part of the recovery measures will be permanent (85%) as e.g. income tax cuts, social contribution rate reduction and a reduction in the VAT rate for pharmaceuticals. The temporary measures include labour market support (short-time work), a regional economic stimulus package and vouchers for renovation of buildings with a view to energy conservation. The deficit criterion in the Treaty is not fulfilled.

According to data notified by the Austrian authorities in October 2009 the general government gross debt has been above the 60% of GDP reference value since 2008 and is planned to stand at 68.2% of GDP in 2009. The Commission services' autumn 2009 forecast expects the debt ratio to rise further to 73.9% in 2010 and 77% of GDP in 2011. The debt ratio cannot 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. The debt criterion in the Treaty is not fulfilled.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Austria, the double condition is not met. Considered on their own merit, the relevant factors in the current case present a mixed picture.

The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3)

The Commission, having taken into account its report under Article 104(3) and the opinion of the Economic and Financial Committee under Article 104(4), is of the opinion that an excessive deficit exists in Austria. This opinion, adopted by the Commission on 11 November 2009, is herewith addressed to the Council according to Article 104(5). The Commission recommends that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to Austria with a view to bringing the situation of an excessive deficit to an end according to Article 104(7).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 104(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned as well as a deadline for the correction of the excessive deficit, which "should be completed in the year following its identification unless there are special circumstances". Article 2(6) of the Regulation implies that the "relevant factors" considered in the Commission report under Article 104(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

In the case of Austria, special circumstances are considered to exist. In particular, the economy faces a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. The downturn reflects the abrupt decline in private investment and foreign trade in the export-oriented manufacturing sector as a consequence of the global financial and economic crisis. As a consequence GDP contracted by about 4.2% in the first half of 2009. According to the Commission services' 2009 autumn forecast, real GDP in Austria is projected to contract sharply in the year 2009 by -3.7% compared with growth of 2% in 2008. Also according to the Commission services' autumn 2009 forecast, taking into account the fiscal measures adopted in the current year, the deficit would widen to 5.5% in 2010 and 5.3% of GDP in 2011 on a no-policy change assumption. This assumption takes into account that, according to government plans, a large part of the measures of extraordinary nature linked to the crisis in line with the EERP will be maintained in 2010 and 2011. Benefitting from a close to balance budgetary position in 2008, Austria adopted appropriate additional fiscal stimulus measures reaching 1½% of GDP in 2009 and ½% of GDP in 2010. A major part of the recovery measures will be permanent (85%) as e.g. income tax cuts, a reduction of social contribution rates and a reduction in the VAT rate for pharmaceuticals. The temporary measures include labour market measures (short-time work), a regional economic stimulus package and energy vouchers for thermal renovation.

Considering the special circumstances and the EERP framework, an average annual structural budgetary adjustment is recommended. The required adjustment should take into account the fiscal room for manoeuvre which is assessed on the basis of all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In calculating the average annual adjustment, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total structural adjustment needed to reach the nominal deficit target of 3% by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

Against this background, it is appropriate to consider the correction of the excessive deficit in a medium-term framework with a deadline for the correction of 2013. Recognising that the Austrian budgetary position in 2009 resulted from measures amounting to 1½% of GDP, which were an appropriate response to the European Economic Recovery Plan, and the free play of automatic stabilisers, the Austrian authorities should implement the fiscal measures in 2010 as envisaged. In particular, in view of the absence of major economic imbalances, a credible and sustainable adjustment path would require the Austrian authorities to ensure an average annual structural adjustment of ¾% of GDP over the period 2011-2013, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus and specify the measures that are necessary to achieve the correction of the excessive deficit by 2013 cyclical conditions permitting and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

General government gross debt has been above the 60% of GDP reference value since 2008 and, according to the EDP notification of October 2009, is planned to stand at 68.2% of GDP in 2009. According to the Commission services' autumn 2009 forecast, the debt ratio is expected to stand at 69.1% of GDP in 2009 and to rise further to 77% in 2011 on a no-policy change assumption. According to the April 2009 update of the stability programme, the debt ratio is projected to rise from 73% in 2010 to almost 80% of GDP in 2013. Rapid budgetary consolidation is therefore also necessary with a view to bringing the government gross debt ratio on a declining path that approaches the 60% of GDP reference value at a satisfactory pace. Therefore, the Austrian authorities should seize any opportunity beyond the structural budgetary adjustment, to accelerate the reduction of the gross debt ratio back towards the reference value.

The required consolidation efforts could be supported by the recent 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. 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, fiscal discipline at all levels of government could be strengthened through enhanced transparency and accountability notably by aligning legislative, administrative and financing responsibilities between the different levels of government. Moreover, scope for efficiency gains remains in several areas of public spending, in particular in health care and education.

With regard to the long-term sustainability of public finances, 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 risks from the financial sector stabilisation schemes implemented in response to the crisis 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 as well as reforms aimed at limiting the increase in age-related expenditure, including by rising the effective retirement age, would help to reduce the risk as defined by the Commission Communication[6] on 'Long-term sustainability of public finances for a recovering economy' and endorsed by the ECOFIN Council[7] on 10 November 2009.

Enhanced surveillance under the EDP, which seems necessary in view also of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the stability programme which will be prepared between 2010 and 2013 could usefully be devoted to this issue.

Key projections of Commission services' autumn 2009 forecasts

	2007	2008	2009	2010	2011
Real GDP (% change)	3.5	2.0	-3.7	1.1	1.5
Output gap[1] (% of potential GDP)	2.5	2.8	-2.2	-2.6	-2.7
General government balance (% of GDP)	-0.6	-0.4	-4.3	-5.5	-5.3
Primary balance (% of GDP)	2.2	2.1	-1.4	-2.5	-2.1
Cyclically-adjusted balance[1] (% of GDP)	-1.7	-1.8	-3.3	-4.3	-4.0
Structural balance[3] (% of GDP)	-1.7	-1.8	-3.3	-4.3	-4.0
Government gross debt (% of GDP)	59.5	62.6	69.1	73.9	77.0

Notes:
[1] Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.
[2] Based on estimated potential growth of 1.7%, 1.7%, 1.2%, 1.4% and 1.6% respectively in the period 2007-2011.
[3] Cyclically-adjusted balance excluding one-off and other temporary measures. There are no one-offs and other temporary measures according to Commission services' autumn forecast.
Source:
Commission services' autumn 2009 forecasts (COM); Commission services' calculations.

6 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf.
7 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf.