AUSTRIAN
STABILITY PROGRAM

2nd update for the period 2003 to 2007

(working translation)

Federal Ministry of Finance

Vienna, November 18, 2003

FEDERAL MINISTRY
OF FINANCE

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1. Introduction and summary

In accordance with Regulation (EC) No 1466/97, every member state is required to annually submit a stability program (members of EMU) or a convergence program (non-members). Austria thus submits the 2nd update of her stability program for the years 2003 to 2007. The program's structure reflects the agreements reached by the ECOFIN-Council on July 10, 2001 (Code of Conduct).

This update of the Austrian stability program was produced only approximately six months after the circulation of the first update on March 25, 2003. Hence, for the years 2004 - 2007, the document differs in some parts from the first update.

Above all, the program establishes that in 2002 a balanced budget was achieved for the second year in a row. Budgetary developments in the current stability program result from the implementation of the government program and also take account of the effects of the stimulus packages of the years 2001 and 2002, as well as the growth and competitiveness package of 2003.

Despite the implementation of these additional measures the fiscal balance will not worsen. Accordingly, even with the major tax reform of 2004/2005 the deficit will amount to only 0.4% of GDP in 2007. The debt ratio will stay on a declining path and, with ongoing privatisation efforts, is set to reach a level below 60% of GDP in 2007.

With this 2nd update of the stability program for the years 2003 to 2007 Austria continues to be firmly committed to the goals of the stability and growth pact. The major government policies are set to:

- **strengthen the driving forces of growth through initiatives in the areas of R&D, infrastructure, and education, aiming to complement European initiatives in these areas**

- **increase Austria's attractiveness as a business location, especially in view of the enlargement of the European Union**

- **accelerate the lowering of the tax burden by putting more emphasis on ecological elements of the tax system in accordance with the respective policies of the European Union, as well as by reducing indirect labour costs**

- **continue structural reforms on the expenditure side of the budget, especially by implementing the next steps in the reform of the public administration and of the co-operation between the different levels of government**

- **achieve long-run financial sustainability of the Austrian pension system**

- **continue the privatisation efforts**

- **restructure the Austrian railways**

These measures substantially increase the growth potential of the Austrian economy.

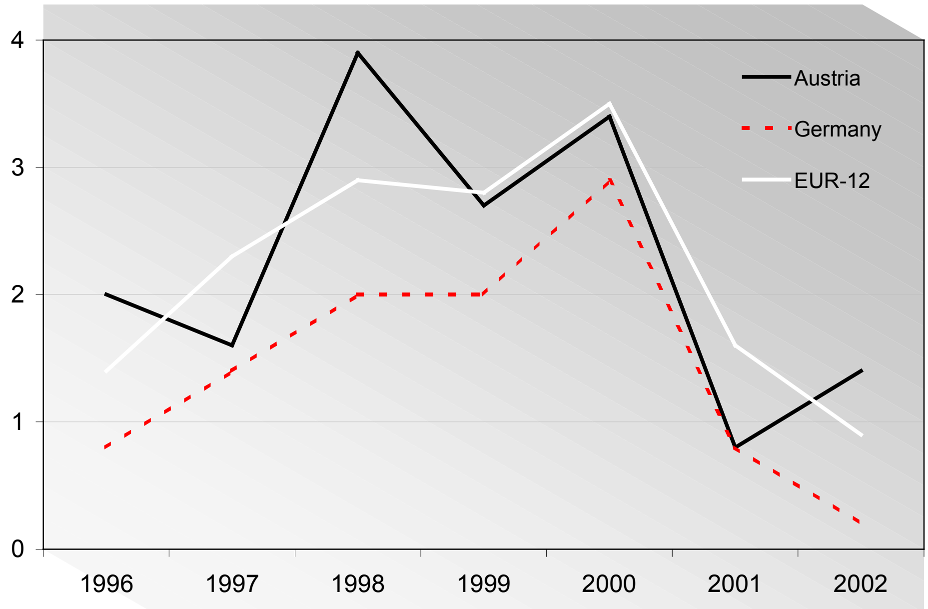
This program is available on the web-site of the Austrian Federal Ministry of Finance: http://www.bmf.gv.at.

2. Austria's economy in the period 2002 to 2007

2.1. Successful stimulus packages generate significant growth effects

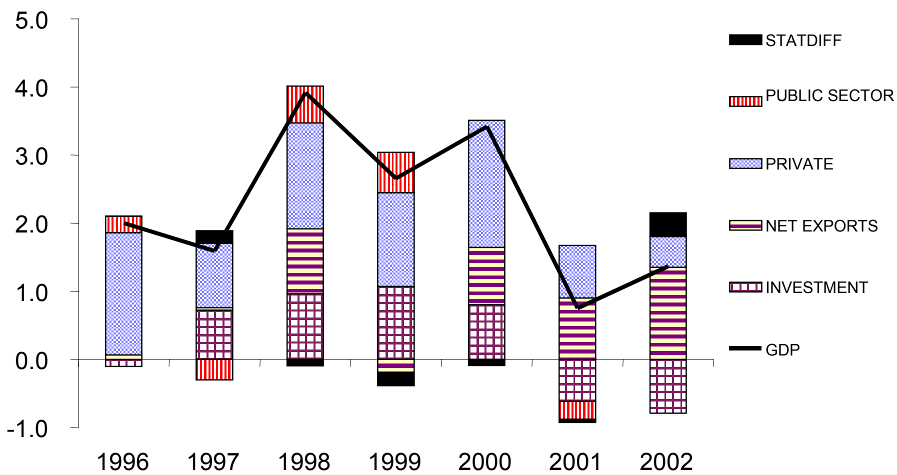
In 2002 Austria exhibited a real GDP growth of 1.4% (figures 1 and 2). Driving force for growth were net exports, mainly to the CEE countries. Growth of imports was strongly dampened, due to declining investment activity during this year. In 2002 exports increased by 3.7% in real terms, whereas imports only rose by 1.2%. The available data for the year 2003 indicate that the continuing economic slowdown in Europe will also effect Austrian net exports negatively.

Figure 1: Economic growth from 1996 to 2002



Source: Statistik Austria, European Commission

Figure 2: Real growth contribution to the Austrian GDP
as a percentage from 1996 to 2002



Source: Statistik Austria

The stimulus packages of the years 2001 and 2002 both exerted a positive effect on growth in 2003. The Austrian Institute for Economic Research estimates that the two stimulus packages resulted in an additional real GDP growth of 0.5% to 0.75% (see box). With an expected real economic growth of 0.9% in 2003 both stimulus packages will therefore have provided an important growth impetus. The deterioration of investment expenditure came to a halt, and thus Austria successfully unlinked its economy from the business cycle developments of the most important trading partners.

Evaluation of the stimulus packages 2001 and 2002 by the WIFO:

- Infrastructure investments were accelerated (Schig, Asfinag)
- Investment gain bonus increased investment in equipment by 1.5%
- Measures for R&D, education and trainees gained a high level of recognition
- 1/5 of all entrepreneurs active in R&D made use of R&D policy measures
- 17% more continued education was stimulated by premiums
- 1/3 of all companies with training schemes (15% of all) had one or more apprentices

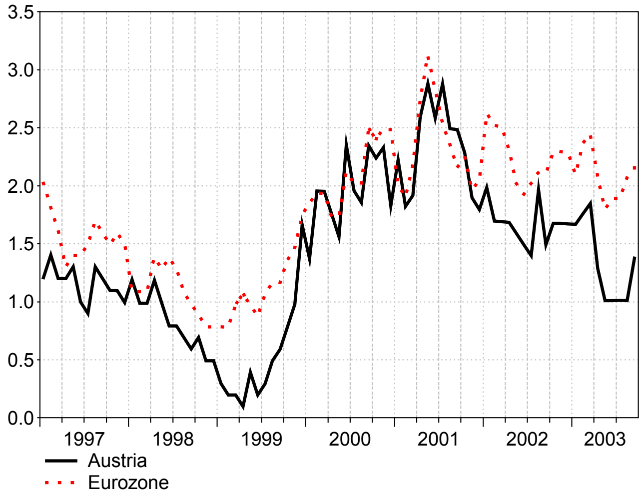
Growth effect:

- 0.25% of real GDP in 2002
- up to 0.75% of real GDP in 2003 (2/3 buildings and infrastructure, 1/3 equipment investment)

In 2003 domestic demand will again be the engine of growth. As prices for consumption goods rise slower than disposable income, gains in purchasing power will contribute positively to final demand.

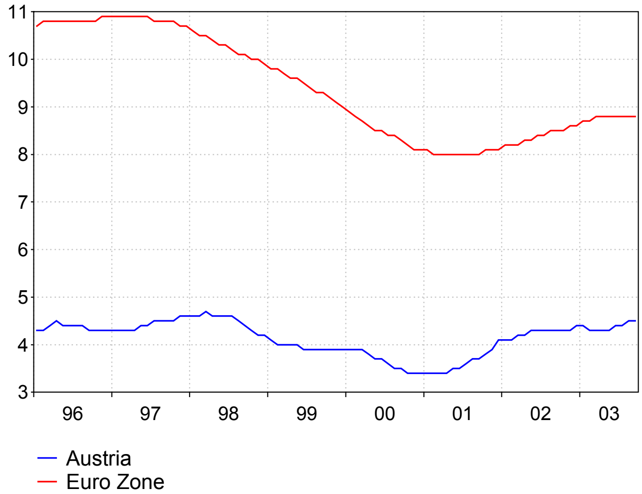
With regard to price-developments Austria is one of the most stable countries in the EU. Inflation – according to the HICP – further decreased in 2003 and amounted to 1.3% as of September 2003. The price increase in the second quarter of 2003 has slowed down more than expected and remains even more visibly under the EU average (figure 3).

Figure 3: Harmonised consumer prices
Austria and the EMU 1997 –2003, monthly values, changes compared to the previous year in %



Source: EcoWin

Figure 4: Unemployment
in Austria and the Eurozone 1996 to 2003 standardised, in %



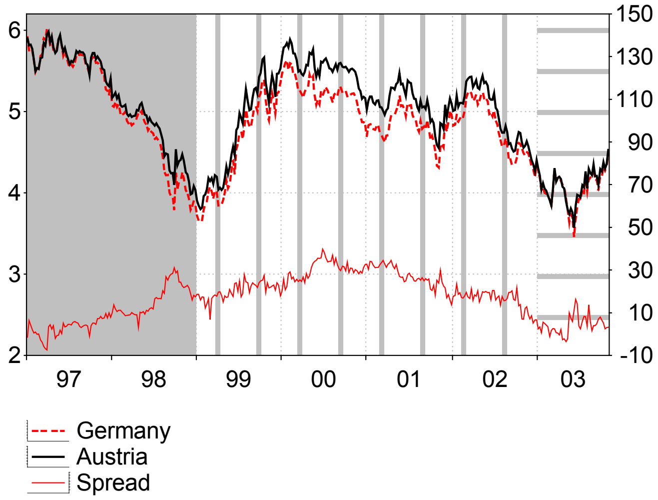
Source: EcoWin

Employment continued to increase in 2003. In September 2003 the increase compared to the same month of the last year amounted to 1.1% (3,230,000 dependant employees in 2003 compared to 3,196,500 in September 2002). The number of job seekers was, nonetheless, also increasing. In October 2003 the number of unemployed was 4.7% (10,120 persons) above the value of the previous year. The unemployment rate amounts to 4.5% (figure 4). Youths (between 19 and 25) and university graduates are disproportionally affected by the hike in unemployment figures, while the labour market has stabilised for older workers.

Since mid-2003, the yield of long-term government loans is around 4%. In 2003, the interest differential (spread) decreased perceivably compared to Germany.

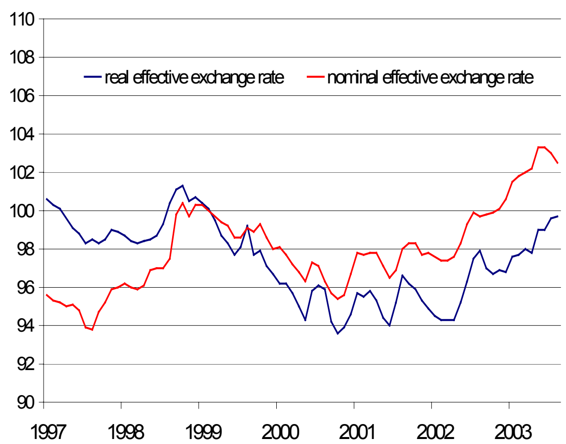
Since 2000, the consolidation policy aiming at stabilisation has reached a decrease in the spread of 30 base points, which equals a budgetary relief of more than € 400m (around 0.2% of GDP).

Figure 5: Long-term interest rates
in %, Austria and Germany, since 1997, and spreads in base points (right-hand scale)



Source: EcoWin

Figure 6: Effective exchange rates
nominal and real, from 1997 to 2003
(1st quarter 1999 = 100)



Source: Wifo

The external value of the Euro is clearly above the estimations underlying the last update of the stability program – especially when compared to the US-Dollar. From the beginning of 2002 until May 2003 the Euro appreciated nominally by nearly 40% compared to the US-Dollar. Since then the exchange rate fluctuated between 1.08 and 1.18 US-Dollar to 1 Euro.

In the development of the nominal and real effective exchange rates an appreciation was also noticeable since October 2000, but considerably less significant (figure 6).

A small surplus is forecast for the foreign trade balance in 2003, as was also the case for 2002. The current account deficit was completely eliminated in 2002 due to decreasing imports of goods and slightly increasing exports. The surplus amounted to around 0.25% of GDP. A balanced current account is expected for the year 2003.

Since the output gap is still significantly negative (table 2) the government is continuing to strengthen the economy with initiatives in the areas of R&D, infrastructure and education, all within the context of the Growth and Competitiveness Package.

Growth and Competitiveness Package 2003:

Strengthen Austria's research capacities

- Goal of the R&D–plan: attain levels of 2.5% of GDP until 2006, and 3.0% of GDP until 2010 in R&D-expenditures
- Establishment of a national foundation for research, technology and development with expected yields of € 125m per annum
- Use of public funds for R&D in the public and private sectors at a 1:2 ratio
- Rule 25/8: research allowance of 25% or alternatively a research premium of 8% for expenditures according to the "Frascati-Manual", research allowance of 35% for R&D expenditures of value to the economy
- University package: € 22m for further improvements in the equipment of universities and universities of applied sciences (Fachhochschulen)

Enforcing of investment and establishment of new businesses

- Extension of the increased investment premium until December 31st, 2004

Measures to offset destruction by disaster damage

- Extension of the special regulation for a accelerated depreciation of replacement in buildings due to disaster damage
- Improvement in the taxation of agricultural communities after natural catastrophes

Impulses for the construction industry

- General renovation of the Vienna Business University (€ 57.7m)
- Protection of monuments (€ 5.2m)
- Promotion of investments improving the access of disabled people to companies (€ 3m)
- Establishment of a second provincial criminal court and detention centres for Vienna, which shall be covering up to a third of all cases

Renewable energy initiative

- Additional federal funds of € 5m (€ 17m if the co-financing of provinces and local communities is considered) cause investments of € 55m in the area of renewable energy

Strengthening of SMEs, start ups and venture capital

- Guarantees and loans for small and medium enterprises as well as start ups
- Provision of additional funds to strengthen equity capital for SMEs with so-called Double Equity Funds of the AWS (Austria Wirtschaftsservice Gesellschaft)

Austrian and European infrastructure strategy for 2010

- € 20bn for the years 1999 up to 2006 to extend traffic infrastructures (20% for main roads, 33% for motorways, 47% for the railway system)
- Projects in the framework of the European growth initiative (TEN) with an expected volume of € 12bn of projects concerning Austria
- Use of private public partnerships (PPP)
- Provide rural areas with high speed internet access (€ 10m)

Labour market initiative

- Premiums for the training of apprentices: since the end of 2002 € 65m have been paid out
- Additional € 23m for the implementation of the € 200m special program starting 2004
- Reform of apprenticee training programs: shift to a modular system will subsume 260 professions into 100 basic modules, only with the second year of training specialisation will take place
- Extension of the provision of schooling for 5.500 trainees without apprenticeships
- Personal assistance on the job for persons with significant physical disabilities (€ 3m)

Internationalisation strategy

- Additional measures promoting exports for 2003 and 2004 of € 50m per year (€ 25m provided for by the federal government, € 25m by the chamber of commerce) with special focus on motivating small enterprises to engage in international trade.

2.2. Economic developments in the period 2004 to 2007

Table 1: Economic trends 2001 to 2007 (percentage change on previous year)

	ESA-Code	2001	2002	2003	2004	2005	2006	2007
GDP growth at constant market prices	B1g	0.8	1.4	0.9	1.9	2.5	2.5	2.4
GDP in billion €*	B1g	212.5	218.3	223.3	230.5	239.7	249.0	258.7
GDP deflator		2.1	1.4	1.4	1.3	1.5	1.4	1.5
Private consumption deflator		2.2	1.1	1.3	1.2	1.3	1.6	1.7
HICP		2.3	1.7	1.3	1.2	1.5	1.7	1.8
Dependent employment**		0.5	0.2	0.2	0.5	0.9	1.0	0.8
Labour productivity growth***		0.3	1.4	0.8	1.3	1.6	1.5	1.6
Wages/head		1.7	2.2	2.0	2.3	2.6	2.5	2.7
Unit labour costs		1.4	0.8	1.3	1.0	1.0	0.9	1.0
Unemployment rate; EU-definition		3.6	4.3	4.5	4.4	4.1	4.0	3.9
Current account balance as % of GDP		-1.9	0.2	0.0	-0.2	-0.5	-0.5	-0.5
Sources of growth: percentage changes at constant prices								
1. Private consumption expenditure	P3	1.4	0.8	1.4	2.0	2.0	1.8	1.4
2. Public consumption expenditure	P3	-1.4	0.1	0.0	0.3	0.2	0.2	0.5
3. Gross fixed capital formation	P51	-2.5	-3.3	1.6	2.7	3.7	3.9	3.6
4. Changes in inventories	P52+P53	-0.3	0.3	-0.1	0.0	0.0	0.1	0.0
5. Exports of goods and services	P6	7.5	3.7	-0.2	2.9	5.6	5.4	5.3
6. Imports of goods and services	P7	5.9	1.2	0.5	2.8	5.0	4.8	4.7
Contribution to GDP growth								
7. Final domestic demand (1+2+3)		-0.1	-0.3	1.1	1.8	2.0	1.9	1.7
8. Change in inventories (=4)	P52+P53	0.0	0.3	0.0	0.0	0.1	0.1	0.2
9. External balance (5-6)	B11	0.9	1.4	-0.2	0.1	0.4	0.5	0.5
Basic assumptions								
Short-term interest rate		4.3	3.3	2.3	2.3	3.2	3.2	3.2
Long-term interest rate		5.1	5.0	4.1	4.4	4.8	5.0	5.0
US-$/Euro Exchange rate		0.896	0.945	1.13	1.16	1.15	1.1	1.1
GDP world, real		2.4	3.0	4.0	4.6	4.6	4.6	4.6
EU-15 GDP, real		1.7	1.1	0.8	2.0	2.4	2.5	2.4
Oil price in US-$/barrel		23.6	24.1	28.3	25.6	24.1	23.9	23.3

* Schilling-entry rate of 13.7603 Schilling/Euro

** According to social security statistics

*** GDP-growth/employed

Source: Statistik Austria; Federal Ministry of Finance

3. Economic policy up to 2007

The economic policy strategy of the government was described in great detail in the first update for the years 2003 to 2007. The strategy has steadily been implemented and, besides the continuation of the reform of the public administration also contains the next step of the reform of the pension system (harmonisation of the systems and introduction of individual pension accounts). Moreover, the tax reform of 2004/2005 is an important step towards improving Austria's position as an attractive business location and for strengthening employment and purchasing power.

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

It is the goal of Austrian economic policy to actively contribute to stable and balanced economic developments in Austria, the European Union and the Euro-zone. Austria is therefore explicitly committed to the Stability and Growth Pact.

Table 2: Cyclical developments and budgetary balances, 2002 to 2007

% of GDP	ESA Code	2002	2003	2004	2005	2006	2007
1. GDP growth at constant prices	B1g	1.4	0.9	1.9	2.5	2.5	2.4
2. Actual balance*	B9	-0.1	-1.3	-0.7	-1.5	-1.1	-0.4
3. Interest Payments	D41	3.7	3.6	3.5	3.3	3.3	3.2
4. Potential GDP-growth**		1.9	1.9	1.9	2.0	2.0	2.0
5. Output gap		0.0	-1.0	-1.0	-0.5	0.0	0.4
6. Cyclical budgetary component		0.0	-0.3	-0.3	-0.2	0.0	0.1
7. Cyclically adjusted balance		-0.2	-1.0	-0.4	-1.3	-1.1	-0.5
8. Cyclically adjusted primary balance		3.6	2.6	3.2	2.0	2.2	2.7

*including tax reform and SWAP-operations
**HP-filter method
NB: Rounding differences are possible. The cyclically adjusted budget balance may vary by +/- ¼ percent of GDP.
Sources: Statistic Austria, Federal Ministry of Finance.

In the last legislation period public budgets were put into balance. In this legislation period the long run sustainability of public balances will be a priority. The pension reform of 2003 will already create expenditure side savings in the medium run.

The main concern of the federal government is to reduce the tax ratio until 2006 to a level below 43% of GDP. With the implementation of expenditure side measures contained in the government program all prerequisites for a comprehensive tax reform are given. Spending as a share of GDP is clearly decreasing. Between 2003 and 2007 it will be lowered by more than 3 percentage points of GDP (Table 3).

The planned tax reform should lead to a tax relief of 1.3 percent of GDP. The federal government expects that the tax reform will clearly improve the status of Austria as a business location, that it will create employment and investment impulses, increase investment in R&D and human capital as well as strengthen positive effects on the quality of living and the environment.

Even with the tax reform the public deficit will never exceed the cyclical safety margin to the upper bound on public deficits of 3% of GDP. In the medium run, a budget that is "close to balance" is secured.

3.2. Public finances in 2003

With € 3.9bn, the budgeted Maastricht-deficit of the Central government exceeds the 2002 value (€ 1.7bn) by € 2.2bn. The reasons are mainly delayed expenditures due to the flood damage relieves of 2002, the low revenues of cyclically dependent taxes due to the weak economic performance and the increased spending for unemployment benefits (automatic stabilisers), the budgetary effects of the stimulus packages I and II in 2002, the improved family benefits and the increase in pension payments. On the revenue side the reform of the import sales tax will have a one-off effect of minus € 0.4bn (0.18% of GDP).

The implementation of the budget for 2003 is restrictive and firmly on track. The federal deficit will not exceed € 3.9bn or 1.8% of GDP. Combined with the surplus from provinces and communities a national deficit of 1.3% of GDP is certain to be achieved.

The restrictive measures (i.e. in personnel, cuts in non-obligatory spending) have been adopted as planned. Due to weak economic performance the revenues of income taxes are less than expected, the developments of wage taxes and VAT partly offset these losses. Tax revenues will therefore comply with the budget proposal.

Despite the economic slowdown, which also leads to decreased pension contributions, federal support of pension security providers should be less than what has been provided for in the budget by approximately € 180m (0.08% of GDP). Due to increased unemployment approximately € 75m (0.03% of GDP) more will be spent on unemployment benefits than projected.

Correspondingly, for salaries for the actively employed the budget plan for 2003 will be adhered to. The additional expenditures resulting from wage increases for 2002 are compensated for by a decrease in staff. The federal spending on pensions for civil servants so far points towards exceeding the budget plan. Spending on family benefits is slightly above the budget plan. These deviations will again be compensated for by a strict implementation of the budget plan on the revenue and expenditure side, as was the case in 2002.

3.3. The federal budget in 2004

The public budget for 2004 was already approved by the national assembly in June 2003. It proposes a federal deficit of 1.4% of GDP. On the national level, due to budget surpluses of provinces and communities, a deficit of 0.7% shall be reached (Table 3).

Consolidation measures will be continued in accordance with the government program. In the education sector savings will be achieved due to reduced weekly teaching hours for students. Decreases in student numbers in compulsory schooling lead to a reduction in teachers as required. The pension reform of 2003 leads to noticeable budgetary relieves in 2004 already. Overall spending was budgeted in a very restrictive way. The budgetary proposal 2004 therefore lives up to the proposed levels of the previous stability program.

By January 1st 2004, the first part of the tax reform will be implemented. In combination with effects of the stimulus packages of 2002, which will lead to yearly decreases in revenues between 2003 and 2006, the tax reform will reduce revenues in 2004 substantially. The federal government expects a reduction of € 0.5bn.

Compared to the tax revenues of 2003 public revenues will increase in 2004 by € 3.2bn. This increase is mainly due to the fact that VAT will again be collected 12 times a year, while it is only collected 11 times in 2003, because of the abolished 13th VAT pre-payment in 2003. On the revenue side no more revenues from the BIG are foreseen (2003: € 341m). The modification of the timing of collecting the VAT on imports causes a shift of € 400m revenues from 2003 to 2004. Additionally, less dividends are expected than in 2003.

3.4. Public finances from 2004 to 2007

In the medium run, a number of reforms with an impact on the budget are envisaged or have already been enacted. On the expenditure side, these reforms are:

Reform of public administration and public employment: In order to enhance efficiency in public administration, the federal government has set itself the goal to reduce public employment by 10,000 until the end of 2006. In this way, nominal expenditures on public employment shall be kept stable and the size of Austria's public sector will be reduced to the OECD-average. Over-time work will be reduced by 8% until 2006. This reform process shall be continued even after this legislative period.

Pension security reform: The pension security reform of 2003 aims in particular at aligning the *de facto* with legal retirement entry ages. It aims simultaneously at providing the private sector with an appropriate incentive to increasingly hire older workers. (Target: Raising the participation rate of older employees to the Stockholm-level). This reform also contributes to the long run sustainability of the Austrian pension system.

Health care reform: By enhancing both the efficiency and the economic rationale of the health care system, the federal government intends to secure the financing of the mandatory health insurance, which is presently running a deficit (see Chapter 6).

Labour market policy measures: In order to raise overall employment and participation rates and to simultaneously improve social security – particularly for older persons and women – the federal government will provide incentives to favour a higher effective retirement age rather than early exits from working life.

Further saving shall be achieved by a revision of the federal aid system, a reform of the state-owned rail company (ÖBB), a redistribution of tasks provided by federal state, provinces and local authorities and a reform of the social security institutions.

Regarding research, education and infrastructure the main measures are:

- R&D: Already in this legislative period, substantial additional funds will be directed to research and development. The basic financial endowments of the research funds, which are crucial for research promotion, will be raised again. The entire research aid system will be simplified; existing instruments will be pooled. (see the Growth and Competitiveness Package)

- Education: Universities obtain full autonomy on January 1st, 2004. It is planned that the federal state and the universities will conclude agreements on a three-year basis, stipulating all mutual obligations. "Fachhochschulen" – a newly established form of colleges complying with the international definition of academic schools – have lately proliferated rapidly; a qualitative consolidation and final determination of subjects offered is proposed. This shall enable the creation of a "critical mass" to secure the most economic use of public money. From 2004 to 2006, schools will be endowed with additional € 72m for educational projects on innovation.

- Infrastructure: Investments in the transport system shall be increased over the coming years (see the Growth and Competitiveness Package). On the one hand, the system of motorways is to be expanded, gaps are to be closed, supplements to the net are to be established, and capacities within the country are to be adjusted. On the other hand, the rail road system needs to be expanded and to show greater efficiency, better customer service and an increase in individual travel and freight transportation.

On the revenue side a major tax reform according to the government program will be implemented in two steps.

First stage starting January 1st 2004

Volume of approx. € 0.9bn, net-effect of approx. € 0.5bn (0.25% of GDP)

This stage will include the following measures:

- **Relief** for low and medium incomes by increasing the tax free thresholds in the income tax law (complete tax relief for yearly gross incomes up to nearly € 14,500).

- **Promotion** of the formation of equity capital in companies via the introduction of preferential taxation treatment for reinvested profits for single proprietorships and corporations with incomes from farming and forest industries or trade establishments (half the average tax rate).

- **Strengthening** of ecological components in the Austrian tax system in accordance with the European Union (taxes on energy and mineral oil products)

- **Lower the indirect labour costs** especially for **older workers**

- The 13th VAT exceptional pre-payment has already been abolished in 2003

The second stage of tax reforms follows on January 1st 2005 with a net relief of € 2.5bn.

All in all, the tax relief will amount to approx. € 3.0bn, or 1.3% of GDP. The level of **taxation** is **lowered significantly below 43%.**

Table 3 shows the developments of individual expenditure and revenue categories according to the normal scenario including the tax reform. Measured as a percentage of GDP, expenditures shall decrease from 2003 to 2007 by 3.5 percentage points. Public revenues will also decrease by 2.7 percentage points.

Within the normal scenario, the debt ratio, given the projected deficit developments, remains on a clear downward trend path (see table 4), which is enforced by the repayment of the debt issued for public enterprises. The macroeconomic picture and the primary balance are sufficient to compensate the still high interest effects and to keep the debt ratio on a declining path. The debt ratio is expected to decline below the reference value of 60% in 2007.

3.5. Provinces and local authorities

The Austrian stability pact was also fully respected in 2002. (Table 3). The current version of the Austrian stability pact is valid until 2004.

Table 3: Budgetary developments 2001 to 2007

% of GDP	ESA Code	2001	2002	2003	2004	2005	2006	2007
Net lending by sub-sectors								
1. General government*	S13	0.3	-0.1	-1.3	-0.7	-1.5	-1.1	-0.4
2. Central government**	S1311	-0.5	-0.8	-1.8	-1.4	-2.2	-1.9	-1.1
3.Provinces (excl. Vienna)**	S1312	0.5	0.4	0.3	0.4	0.4	0.4	0.4
4. Local governments (incl. Vienna)**	S1313	0.3	0.2	0.2	0.3	0.3	0.3	0.3
5. Social security funds	S1314	0.0	0.0	0.0	0.1	0.0	0.0	0.0
General government (S13)								
6. Total receipts*	ESA	52.0	51.2	50.6	50.0	48.5	48.3	48.0
7. Total expenditures*	ESA	51.8	51.3	51.9	50.7	50.0	49.4	48.4
8. Budget balance* (6-7)	B9	0.3	-0.1	-1.3	-0.7	-1.5	-1.1	-0.4
9. Net interest payment	D41	3.7	3.6	3.6	3.5	3.4	3.3	3.2
10. Primary balance(9+8)		4.0	3.5	2.4	2.8	1.9	2.2	2.8
Components of revenues								
11. Taxes	D2+D5	29.7	28.9	28.7	28.4	27.3	27.3	27.2
12. Social contributions	D61	16.7	16.6	16.6	16.4	16.3	16.3	16.2
13. Other		5.3	5.3	5.0	4.7	4.6	4.4	4.3
14. Total receipts	ESA	51.9	51.0	50.5	49.8	48.4	48.1	47.8
14a. Tax burden according to SNA***		45.4	44.2	43.9	43.4	42.3	42.1	41.9
Components of expenditure								
15. Collective consumption	P32	7.3	7.0	7.0	7.0	6.9	6.8	6.8
16. Social transfers in kind	P31	11.6	11.6	11.6	11.4	11.2	11.1	10.9
17. Social transfers others than in kind	D62	18.6	18.9	19.2	19.1	18.9	18.8	18.6
18. Interest payments	D41	3.7	3.6	3.6	3.5	3.4	3.3	3.2
19. Subsidies	D3	2.6	2.7	2.7	2.8	2.8	2.8	2.7
20. Gross fixed capital formation	P51	1.2	1.1	1.1	1.0	1.0	1.0	1.0
21. Other		6.8	6.4	6.6	6.0	5.9	5.7	5.4
22. Total expenditure	ESA	51.8	51.3	51.9	50.7	50.0	49.4	48.4

*including SWAP-Operations
** The current financial burden sharing is valid until 2004
***From D2+D5+D61 imputed social contributions are subtracted, inheritance taxes are added.
NB: there are rounding differences
Sources: Statistic Austria, Federal Ministry of Finance

Table 4: Trend in public debt 2001 to 2007

	ESA Code	2001	2002	2003	2004	2005	2006	2007
Government debt in billion €		142.7	145.7	148.2	151.7	153.6	155.1	155.0
% of GDP								
Government debt ratio		67.1	66.7	66.4	65.8	64.1	62.3	59.9
Change in government debt ratio		2.5	-0.4	-0.3	-0.6	-1.7	-1.8	-2.4
		Contribution to change in debt ratio						
Primary balance	B9	-4.0	-3.5	-2.4	-2.8	-1.9	-2.2	-2.8
Public-sector interest payments	D41	3.7	3.6	3.6	3.5	3.4	3.3	3.2
Nominal GDP growth	B1g	-1.6	-1.9	-1.8	-1.8	-2.6	-2.5	-2.5
Stock-Flow Adjustment [1)]		4.4	1.4	0.3	0.5	-0.6	-0.4	-0.3
Implied interest rate on government debt		5.7	5.4	5.4	5.3	5.3	5.3	5.3

1) Residual variable
Rounding differences possible
Source: Federal Ministry of Finance.

4. Sensitivity analysis and comparison with previous stability programs

Table 5 compares current data with those in the update of March 25, 2003. Compared to the update from March 2003 a noticeably more favourable value for the general deficit in 2002 resulted from good developments in tax revenues for the months of November and December 2002 (+0.4% of GDP) and from the revision of GDP for the year 2002 in the framework of the ESA (+0.1%).

Table 5: Economic growth and net borrowing by the public sector between 2002 and 2007; Comparison with the Stability Program of March 2003

	ESA Code	2002	2003	2004	2005	2006	2007
GDP growth, real	B1g						
Stability program March 2003		0.9	1.4	2.0	2.5	2.5	2.4
Stability program Nov. 2003		1.4	0.9	1.9	2.5	2.5	2.4
Difference		0.5	-0.5	-0.1	0.0	0.0	0.0
Actual budget balance	B9						
Stability program March2003		-0.6	-1.3	-0.7	-1.5	-1.1	-0.4
Stability program Nov. 2003*		-0.1	-1.3	-0.7	-1.5	-1.1	-0.4
Difference**		0.5	0.0	0.0	0.0	0.0	0.0
Government debt ratio							
Stability program March 2003		67.8	67.0	65.1	63.8	62.1	59.7
Stability program Nov. 2003		66.7	66.4	65.8	64.1	62.3	59.9
Difference***		-1.1	-0.6	0.7	0.3	0.2	0.2

* including tax reform and SWAP-Operations
** a positive sign denotes an improvement
*** a positive sign denotes a deterioration
Source: Federal Ministry of Finance.

For the sensitivity analysis in the upper scenario below it is assumed that structural reforms and the tax reform result in a growth impulse. The lower scenario assumes a prolonged period of low growth.

Table 6:Economic growth and public households in three scenarios

	2003	2004	2005	2006	2007
	Normal Scenario				
GDP	0.9	1.9	2.5	2.5	2.4
Budget balance as a % of GDP	-1.3	-0.7	-1.5	-1.1	-0.4
Debt ratio as a % of GDP	66.4	65.8	64.1	62.3	59.9
	Upper level growth scenario				
GDP	1.1	2.5	3.2	2.9	2.5
Budget balance as a % of GDP	-1.3	-0.5	-1.3	-0.8	0.1
Debt ratio as a % of GDP	66.3	65.8	63.6	61.3	58.4
	Lower level growth scenario				
GDP	0.7	1.4	1.7	2.2	2.2
Budget balance as a % of GDP	-1.3	-0.9	-1.7	-1.5	-0.9
Debt ratio as a % of GDP	66.5	66.4	65.1	63.8	62.0

Source: Federal Ministry of Finance

The interest rate risks for government debt can be regarded as low. Around 93 percent of government debt carries fixed interest; the average duration for existing debt amounted to slightly less than 6 years by mid 2003. Compared to the normal scenario an increase in existing interest rates on the current debt by 1 percentage point starting 2003 would lead to an increase in the deficit of 0.05% of GDP by the year 2007.

5. Quality of public finances

It is the goal of the Austrian government to enhance the quality of public finances. In this chapter the budgetary structure and the measures of the administrative reform are described. The federal government aims at reducing the size of the public sector to the OECD average. To this end the measures described in the first update of the stability program for the years 2003-2007 (March 2003) will continue to be implemented.

Additional measures, especially with regards to R&D in the context of the reform-dialogue, were included in the Growth and Competitiveness Package of 2003.

5.1. Austrian convention on Constitutional Reform

On May 2nd, 2003, the so-called Austrian Convention set out to set up proposals for a constitutional reform, laying the foundations for a more efficient public administration. In addition, the administration shall be closer to the needs of the citizens and increase its transparency. On July 10, 2003, the following ten committees were established:

Committee 1 – public assignments and objectives

Extensive analysis of public assignments and the issue of public core functions. Question of a comprehensive catalogue of public objectives in the federal constitution.

Committee 2 – structural analysis of constitutional regulations

Proceedings in connection with incorporating constitutional laws and regulations into a new constitutional charter.

Committee 3 – public institutions

Topics: building of the state (federation, provinces, local authorities, self-administration). elections, constitutional autonomy, rapport of legislation and execution considering the legal principles and the legislation of the EU.

Committee 4 – catalogue of fundamental rights

Formulation of a catalogue of fundamental rights considering any relevant national, international and European regulations.

Committee 5 – responsibility assignment between federation, provinces and local authorities

Creation of a clear-cut catalogue of legislative competence focusing on benefits and responsibilities considering the legal position of the European Union.

Committee 6 – administrative reform

Executive competence and composition of administrative bodies (federation, provinces and local authorities), particularly with regard to an efficient expenditure allocation, transparency, reflecting the general public's interests (especially means of participation) and the development of e-government.

Committee 7 – formation of particular administrative bodies

Supervising authorities and other independent regulators, self-governing bodies (excluding local authorities), hived-off legal entities and other businesses.

Committee 8 – democratic controls

Setup of efficient and effective monitoring instruments (federation, provinces and local authorities), rights of parliaments including minority rights (e.g. inquiry boards), audit courts, the ombudsman, obligation of secrecy, means of direct democracy.

Committee 9 – legal protection, jurisdiction

Establishing an efficient and effective legal protection considering decisions close to the people: ordinary jurisdiction, tribunals, administrative jurisdiction at the provincial level, specific senates.

Committee 10 – fiscal constitutional law

Reform of the fiscal constitutional law, in particular with regard to merging responsibilities for revenues and expenditures and the creation of a fiscal equalisation meeting the requirements of the federal, provincial and local level.

The Austrian Convention intends to complete its work and release a final report within 18 months after its constituting session.

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

The demographic projections of Statistic Austria (STATAT) and of Eurostat show a marked increase of the share of older persons in the Austrian population. Current projections of STATAT assume a relatively stable development of the Austrian population at approximately 8.1m. Dependency ratios (share in the population aged 64 and older) are expected to rise from currently 23% to 49% in the years 2040-2050, the share of people older than 80 years will rise even more significantly. The increase in dependency ratios especially accelerates in the period between 2020 and 2040.

6.1. Pension systems

The pension security reform 2003

The pension reform bill passed Parliament in June 2003. The most imperative economic policy aspirations are:

- increasing growth and employment potentials in the medium and long run by providing an augmenting labour supply
- guaranteeing the long run sustainability of public finances
- strengthening the insurance principle within the pension systems
- increasing fairness within and between generations
- increasing fairness of the system

The pension reform contains the following elements:

- An increase in the accounting period for the pension base to the **best 40 years** of earnings (instead of 15/18) until 2028, with increased crediting of child care periods and times for caring deceasing relatives or seriously ill children.
- The annual **accrual rate** is reduced to **1.78 pp** instead of 2 pp
- There will be an overall cap on reform-related pension benefit losses of 10% until 2032.
- **Early retirement** on account of unemployment and early retirement on account of long-term insurance contributions will be fully abolished until 2017; during the transition period, the benefit discount for every year of earlier retirement will be increased to 4.2 pp (instead of 3 pp), up to a maximum of 15 pp. The **premium for later retirement** will be increased by the same amount of 4.2 pp (instead of 3 pp), up to a maximum of 10 pp.
- Regarding the pensions of **tenured civil servants** the act foresees steps mirroring the private sector scheme. Additionally, increases of pension contributions by 1 pp are introduced.

Complementary measures:

- pensioners will have the opportunity to engage in socially insured employment.
- "**Aktion 56/58":** Non-wage labour costs for older workers will be lowered
- Qualification offensive for elderly workers and reform of the bonus/malus system when dismissing/hiring elderly workers

- More restrictive admission to part-time pensions

The next steps will be the introduction of a harmonised pension system and and the introduction of individual pension accounts for all citizens younger than 35 years.

6. 2. Health- and care systems

In 2002 various measures have been taken to activate new, more efficient incentive effects in the health care system.

At the end of October 2003 a broad reform dialogue was initiated to guarantee the long run sustainability of the health care system. First steps will already be taken in 2004:

Measures of 2004

Pharmaceutical package

New reimbursement codex for pharmaceuticals:

- Level red coded drugs do not inhibit a European average price, senior consultant's approval is still demanded, but no more shoe leather costs for patients
- Level yellow coded drugs inhibit European average prices, but have not been negotiated between social security institutions and pharmaceutical industries
- Level green coded drugs may be prescribed without restrictions

Pharmaceutical costs

- After the patent protection period drug prices will decline by at least 30%
- The first generic drug will be cheaper by at least another 25%
- After the second generic drug enters the market, prices are formed freely on the market
- Prescription fees for generic drugs will be reduced to € 2.80 instead of € 4.25
- Margins for whole-sale trade will be lowered by 2pp; for pharmacies by 1pp, plus a "special discount" of 2.5pp for a turn-over above median values; for doctors' pharmacies of 3.6pp above € 65,400.

The yearly increase in drug prices is to be lowered from currently 6-13% to 3-4%.

Changes in the health insurance system:

The budget laws include the following changes, which will already be effective as of 1.1.2004:

- Identical health insurance contributions for blue and white collar employees
- For white collar workers: 7.3% shared by employer (3.7%) and employee (3.6%).
- For blue collar workers: 7.3%; with 3.5% paid by the employer, 3.8% paid by the employee. Additionally leisure accidents demand a deductible of 0.1% to be wholly paid by the insured for all employees and retirees.
- Health insurance contributions for retirees will be raised from 3.75% to 4.75% of the gross retirement benefit in two steps: an increase to 4.25% from 1.1.2004 and to 4.75% from 1.1.2005.

The following changes will be implemented on 1.1.2005 at the earliest:

- Instalment of deductibles for visits to the doctor, etc. Amounts will be discussed with the medical doctors' assembly and social partners.
- Abolishment of outpatients' fees and medical insurance voucher fees

Further measures:

- New regulations for precautionary examinations
- Health advancement programs
- Employment and qualification campaign for caring professions

6.3. Long run sustainability

Table 7 provides an overview of possible budgetary consequences of the ageing process until the year 2050, based on the demographic projections of STATAT of 2001 and the common EU assumptions of the EPC. The data for the health and care sectors are based on projections of old age spending profiles. Calculations have been refined as compared to the last stability program. Currently a long run increase of spending on pensions, health and care services of about 2.5-3.0 pp of GDP until 2050 is projected.

Table 7: Long run sustainability of public finances

Public expenditure as % of GDP	**2005**	**2010**	**2015**	**2020**	**2025**	**2030**	**2035**	**2040**	**2045**	**2050**
Pension expenditure	14.6	14.6	14.6	14.9	15.3	15.8	16.0	15.8	15.4	15.0
of which: *private sector*	*10.5*	*10.8*	*11.0*	*11.4*	*12.1*	*12.7*	*13.1*	*13.0*	*12.6*	*12.3*
Health expenditure	5.1	5.2	5.4	5.6	5.8	6.0	6.1	6.3	6.4	6.4
Care expenditure	0.7	0.8	0.9	1.0	1.0	1.1	1.2	1.3	1.4	1.5
Assumptions *(in %)*										
Dependency ratio (65+/overall)	25	26	29	31	35	41	46	48	48	49
Productivity growth (labour)	2.0	1.9	1.9	1.8	1.8	1¾	1¾	1¾	1¾	1¾
Real GDP growth (5 year average)	1.5	2.3	2.0	1.6	1.5	1.4	1.6	1.7	1.8	1.6
Activity rate (Men 15-64)	76.7	76.5	76.8	77.0	77.2	78.7	80.3	81.2	81.3	81.2
Activity rate (Women 15-64)	60.8	61.7	61.5	61.7	62.4	64.7	67.4	69.0	69.7	70.1
Activity rate (overall 15-64)	68.8	69.2	69.2	69.4	69.9	71.8	74.0	75.2	75.6	75.8
Unemployment rate (EU-definition)	4.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0

The far reaching reforms guarantee the long run sustainability of the public sector. It is to be expected that activity rates and with them growth and employment potentials of the economy can significantly be increased in the long run. The measures additionally slow down the dynamics of expenditures.

7. Horizontal measures influencing public finances

7.1. Capital markets

Two major elements of the action plan for capital markets, which have enhanced the good performance of the ATX, have already been implemented: The 3rd pillar pension reform has passed parliament and the Austrian Corporate Governance Codex was installed. The action plan, which is designed and co-ordinated by the Capital Market Representative of the federal government, focuses on strengthening confidence in the market and on measures to increase market volume.
To improve the funding conditions for enterprises, the domestic capital market and the Viennese Stock Exchange are to be strengthened in the coming legislation period by the following additional measures, which simultaneously are the focus of the action plan of the government's Capital Market Representative:

- Establishment of a legal framework for securitisation of assets (ABS)
- Strengthening of the risk capital market (Venture Capital/Private Equity)
- Improvement and development of new approaches for employee ownership
- Development of measures to strengthen confidence (Corporate Governance, measures against insider trading, strengthening of business accountants)

Another key area for the timeframe of the programme will be the preparations to implement the forthcoming capital-adequacy rules for banks. One focus will be on the future directive, which will follow the recommendations of the Basle Committee ("Basle II"); the other focus will be on accordingly mitigating the imminent effects these new rules will have on the non-financial sector. Further efforts will centre on other EU-directives, such as the directive for financial conglomerates, which shall improve the effectiveness of supervision, or the directive on prospectuses, which regulates the EU-wide recognition of prospectuses approved in the issuer country for public offering resp. acceptance for trading on regulated markets.

7. 2. Privatisation policy

Privatising of public enterprises and the improvement of corporate governance are important goals of structural policies. Table 8 shows these measures since the update from March 2003.

Table 8: Privatising of the federal state:

Fulfilling the current order to privatise of the federal government from April 1st 2003 the following privatisation of the ÖIAG were undertaken:

Aug. 2003:	Sale of 9% of the VA Technologie AG via the stock exchange	€ 33m
Sept. 2003:	100% of the Austrian PostBus AG to the ÖBB	€ 119m
Sept. 2003:	Sale of 19.7% of VoestAlpineAG via the stock exchange and of 15% through an Exchangeable	€ 492m
Total:		**€ 644m**

The net liabilities of ÖIAG amounted to € 1.636bn as of September 30, 2003, compared with € 6bn at the beginning of 2000.

7. 3. Labour market

It is more than ever the goal of labour market policy to actively integrate the long term unemployed, older workers and youth by offering more education incentives and by implementing the Growth and Competitiveness Package. The budget laws 2003 contain a number of changes in active labour market policy and also supportive measures, which aim at speeding up the process of re-integration, especially for older workers. These measures are listed in detail in the Austrian National Action Plan (NAP) for Employment 2003.