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NOVEMBER 2004 UPDATE
OF THE STABILITY PROGRAMME OF AUSTRIA
(2004-2008)
AN ASSESSMENT

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SUMMARY AND CONCLUSIONS¹

The Austrian Council of Ministers adopted the update of the Austrian stability programme on 30 November 2004. It covers the period from 2004 to 2008, and complies with the revised “Code of Conduct on the content and format of stability and convergence programmes”. However, while the consolidation path is legally fixed in a National Stability Pact, the programme remains vague about the specific measures through which a significant budget consolidation could be achieved in the last two years of the programme.

The update’s underlying macroeconomic projection until 2006 is broadly in line with the Commission’s autumn 2004 forecast. Growth is envisaged to pick up from 1.9% in 2004 and to remain at around 2½% over the remainder of the programme period. The programme argues that the current, mainly export-driven, recovery is gradually translating into stronger domestic demand. The upturn is expected to gain momentum, with sizeable tax cuts taking effect in 2005, accompanied by strengthening employment growth. In 2007 and 2008, real GDP is forecast to outpace its potential growth rate, estimated at 2%, by ¼ pp and by ½ pp respectively. As a consequence, the negative output gap, according to the Commission services’ calculations, will close and eventually turn positive in 2008. The update’s short-term macroeconomic assumptions are plausible; however, for 2007/08, the assumption of GDP growth continuing above 2% p.a. appears somewhat optimistic as, in that case, growth would exceed potential for four years in a row.

Compared with the previous programme, the budgetary targets of the update have been lowered by about ½% of GDP in all programme years. The target of reaching a balanced budget has thereby also been pushed back by one year to 2008. From a ratio of 1.3% of GDP in 2004, the deficit is expected to rise to 1.9% of GDP in 2005, after which it first declines slowly to 1.7% in 2006, and then drops to zero in 2008 in two equally large reduction steps. This trajectory reflects a budgetary strategy that combines a sustained lowering of the tax burden with the return to a balanced budget over the medium term. In ESA 95 terms, the tax burden is set to fall from 43% in 2003 to 40% in 2008, reaching the latter benchmark two years earlier than originally envisaged by the government.

Even more than in the previous update, the budgetary path frontloads tax relief, but backloads the corresponding restraint on expenditure. The rise in the deficit in 2005 is dominated by the sizeable tax cuts that will become effective on 1 January. Nevertheless, the budgetary risks appear balanced for 2005 and 2006, particularly in view of the realistic underlying macroeconomic scenario. However, for the outer years 2007/08, there are clear downside risks from, first, the assumption that GDP growth will remain consistently above potential and, second, the fact that the substantial fall envisaged in the expenditure/GDP ratio remains largely unspecified in the programme. The update’s medium-term objective of a budgetary position close to balance in cyclically-adjusted

¹ This technical analysis, which is based on information available up to 22 December 2004, accompanies the recommendation by the Commission for a Council opinion on the update of the stability programme, which the College adopted on 11 January 2005. It has been carried out by the staff of and under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission. Comments should be sent to Heinz Jansen (heinz.jansen@cec.eu.int), Stefan Kuhnert (stefan.kuhnert@cec.eu.int) and Peer Ritter (peer.ritter@cec.eu.int).

terms may thus not be achieved within the programme period. However, it seems to provide a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations over the programme period.

The consolidation path until 2008 has been enshrined in a National Stability Pact between the territorial authorities, which is to be enforced at all levels of government via a penalty system. However, the ambition to forcefully restrain expenditure in these two years is not fully substantiated by those policy measures presented in the programme which have already passed into legislation.

Partially reversing significant upward revisions in previous years, figures for gross government debt have been revised downwards. Since at the same time GDP figures have been revised upwards due to a change in the statistical method, the debt ratio for 2003 has been reduced by nearly 2 pp, to 64.5% of GDP. While this should make it easier to attain the 60% reference value, the date for achieving that target has been pushed back by one year to 2008 as a result of the reduced ambition to bring down the deficit. A scenario with higher growth would move the date forward, while lower growth would push it back by one year. With GDP growth rates assumed to remain practically constant over the programme period, the debt dynamic is dominated by changes in the primary deficit. By way of a positive risk, the update does not include the full potential for privatisations in Austria. The attainment of the debt criterion in 2008 therefore remains plausible, even if slippage should occur in the deficit target.

The ambitious reduction in the expenditure/GDP ratio is projected to be achieved through significant cutbacks across all expenditure categories throughout the programme period. The bulk of the consolidation in the longer term is expected from reductions in social transfer payments. While government investments are reduced over-proportionally, the biggest savings volume stems from reductions in social transfer payments. The update is optimistic about cost savings from presumed future administrative reforms at lower levels of government that have already been implemented successfully at the federal level.

Austria appears to be in a relatively favourable position with regard to the long-term sustainability of public finances, in spite of important projected budgetary costs of an ageing population. The pension reforms of 2003 and 2004 are set to provide substantial budgetary relief in the long term. However, the 2004 reform step further back-loads the consolidation effect: while the plan to adjust pensions from 2030 onwards only for inflation, keeping real benefit levels constant, is indeed ambitious, savings in earlier periods introduced by the 2003 reform step have been taken back to some extent.

The economic policies outlined in the programme are partly consistent with the country-specific broad economic policy guidelines in the area of public finances. Although Austria will lower its high tax burden, this does not go hand-in-hand with expenditure restraint, so that the cyclically-adjusted position of close to balance is projected to be reached only in the final year of the programme.

In view of the above assessment, Austria is recommended to achieve a higher degree of front loading in the overall budget consolidation path. Furthermore, Austria should lay out in greater detail the specific measures through which a significant budget consolidation could be achieved in the last two years of the programme.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	SP Dec 2004	1.9	2.5	2.5	2.2	2.4
	COM Oct 2004	1.9	2.4	2.4	n.a.	n.a.
	<i>SP Nov 2003</i>	<i>1.9</i>	<i>2.5</i>	<i>2.5</i>	<i>2.4</i>	<i>n.a.</i>
HICP inflation (%)	SP Dec 2004	2.1	1.8	1.4	1.5	1.6
	COM Oct 2004	2.1	1.8	1.4	n.a.	n.a.
	<i>SP Nov 2003</i>	<i>1.2</i>	<i>1.5</i>	<i>1.7</i>	<i>1.8</i>	<i>n.a.</i>
General government balance (% of GDP)	SP Dec 2004	-1.3	-1.9	-1.7	-0.8	0.0
	COM Oct 2004	-1.3	-2.0	-1.7	n.a.	n.a.
	<i>SP Nov 2003</i>	<i>-0.7</i>	<i>-1.5</i>	<i>-1.1</i>	<i>-0.4</i>	<i>n.a.</i>
Primary balance (% of GDP)	SP Dec 2004	1.9	1.2	1.3	2.2	2.9
	COM Oct 2004	1.7	0.9	1.2	n.a.	n.a.
	<i>SP Nov 2003</i>	<i>2.8</i>	<i>1.9</i>	<i>2.2</i>	<i>2.8</i>	<i>n.a.</i>
Cyclically-adjusted balance (% of GDP)	SP Dec 2004¹	-0.9	-1.7	-1.6	-0.8	-0.1
	COM Oct 2004	-1.0	-1.9	-1.7	n.a.	n.a.
	<i>SP Nov 2003¹</i>	<i>-0.4</i>	<i>-1.4</i>	<i>-1.1</i>	<i>-0.5</i>	<i>n.a.</i>
Government gross debt (% of GDP)	SP Dec 2004	64.2	63.6	63.1	61.6	59.1
	COM Oct 2004	64.0	63.9	63.4	n.a.	n.a.
	<i>SP Nov 2003</i>	<i>65.8</i>	<i>64.1</i>	<i>62.3</i>	<i>59.9</i>	<i>n.a.</i>
Note: ¹ Commission services calculations on the basis of the information in the programme Sources: <i>Stability programme (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations</i>						

1. INTRODUCTION

The Austrian Council of Ministers adopted the update of the Austrian stability programme on 30 November 2004 and submitted it on the same day. The update covers the period from 2004 to 2008. The programme has been sent to the Austrian Parliament for information and has also been made available to the general public. The update complies with the data requirements of the “code of conduct on the content and format of the stability and convergence programmes”.²

2. MACROECONOMIC DEVELOPMENTS

Apart from minor differences, the update’s macroeconomic baseline scenario is very much in line with the Commission services autumn 2004 forecast. The medium-term outlook appears plausible. There is, however, slight discrepancy in the outlook for the demand components, notably in 2005 and 2006. The programme is more optimistic as regards the strength of domestic demand, whereas the Commission services forecast sees growth relying relatively more on foreign demand. Moreover, in view of a substantial increase in the number of job seekers in October, the programme does not project a significant decrease in unemployment over the forecast horizon. The Commission services forecast, in contrast, is projecting a stronger reduction in 2006.

Apart from the oil price, which is 28 % and 14 %, respectively, below the Commission services’ assumption for 2005 and 2006, the update’s exogenous assumptions are by and large the same as in the Commission services autumn forecast. The update states that, in the case of Austria, oil price hikes have its biggest impact through contractions of foreign demand. The latter is, however, assumed to grow at exactly the same pace as in the Commission services forecast. Furthermore, the Commission services’ higher oil price assumption partly explains its lower forecast of the increase of the GDP deflator in 2005. Therefore, the update’s projection of the GDP deflator and thus nominal GDP growth appears to be slightly optimistic for 2005.

The programme argues that the current, mainly export-driven recovery is showing signs of feeding through to stronger domestic demand. Private investment is expected to pick up again, as an investment premium, which was initially limited to 2003 and has eventually been extended to 2004, induced considerable “carry-forward” effects in 2003 and a dip in capital formation in the first half of 2004. Supported by subdued inflation and by a moderate increase of employment, private consumption has also gradually picked up in 2004. This upturn in private consumption is projected to gain momentum in

² Optional data on participation rates in Table A- 6 cover the age cohort of 20-64 years instead of 15-64 years. Moreover, budgetary data in the main text are partly based on cash statistics while the data in the related tables follow the ESA95 classification (e.g. investment premium). Compared to the Commission assessment (available at

http://europa.eu.int/comm/economy_finance/about/activities/sgp/year/year20042005_en.htm),

the evaluation of compliance follows a reclassification of the degree of compliance into four categories (namely "fully complies", "complies", "broadly complies" and "partly complies"), replacing the previous three-way classification ("complies", "largely complies" and "partly complies").

subsequent years, as a tax reform will come into effect in 2005 and employment growth is expected to further accelerate.

Table 1: Comparison of macroeconomic developments and forecasts

	2004		2005		2006		2007	2008
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	1.9	1.9	2.4	2.5	2.4	2.5	2.2	2.4
<i>Contributions:</i>								
- Final domestic demand	1.3	1.5	2.1	2.6	2.3	2.7	2.2	2.1
- Change in inventories	0.0	-0.3	0.0	-0.1	0.0	0.0	0.1	0.2
- External balance on g&s	0.5	0.8	0.3	0.0	0.1	-0.2	-0.1	0.1
Employment (% change)	0.5	0.6	0.7	0.9	0.8	0.9	0.9	1.1
Unemployment rate (%)	4.2	4.5	3.9	4.3	3.4	4.2	4.1	4.0
HICP inflation (%)	2.1	2.1	1.8	1.8	1.4	1.4	1.5	1.6
GDP deflator (% change)	1.1	1.3	1.2	1.8	1.2	1.5	1.6	1.8
<i>Sources:</i>								
<i>Commission services autumn 2004 economic forecasts (COM); stability programme update (SP)</i>								

Based on the programme's macroeconomic scenario and on Commission services calculations according to the commonly agreed methodology, potential output growth is estimated to remain constant at around 2 %. Real GDP growth is thus forecast to outpace its potential growth rate by ¼ pp. and by ½ pp. in 2007 and 2008, respectively. As a consequence, the negative output gap will turn positive in 2008. This is very close to the Commission services' estimate, which, starting at a somewhat lower level yields a similar adjustment path for the output gap until 2006.

Table 2: Sources of potential output growth

	2004		2005		2006		2007	2008
	COM	SP ³	COM	SP ³	COM	SP ³	SP ³	SP ³
Potential GDP growth ¹	1.9	1.9	1.9	2.0	1.9	2.0	2.0	2.0
<i>Contributions:</i>								
- Labour	0.2	0.3	0.2	0.4	0.2	0.3	0.3	0.3
- Capital accumulation	0.8	0.8	0.9	0.8	0.9	0.9	0.9	0.9
- TFP	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Output gap ^{1,2}	-1.1	-1.3	-0.6	-0.8	-0.2	-0.4	-0.1	0.2
<i>Notes:</i>								
¹ based on the production function method for calculating potential output growth								
² in percent of potential GDP								
³ Commission services calculations on the basis of the information in the stability programme update								
<i>Sources:</i>								
<i>Commission services autumn 2004 economic forecasts (COM); Commission services calculations</i>								

3. BUDGETARY IMPLEMENTATION IN 2004

As the main budgetary measure with effect in 2004, the tax reform package was implemented and parts of the 2005 instalment were carried forward to 2004.³ The reform consisted of a lowering of tax rates (personal and corporate income taxes) equivalent to

³ See the 2003 update of the stability programme of Austria (2003-2007).

0.3 % of GDP, the effect on overall revenues being offset by increases in mineral oil and energy taxes. The measures of the 2005 reform carried forward into 2004 included higher tax allowances for children, equalling about 0.1 % of GDP, which were not financed.

Although the 2003 update of the stability programme already took the tax reform into account, its target of a general government deficit of 0.7 % of GDP in 2004 has been missed by a wide margin. Both the Commission services autumn 2004 forecast and the 2004 update of the stability programme project the 2004 deficit at 1.3 % of GDP. The budgetary slippage is even more significant if one bears in mind that the 2003 deficit turned out 0.2 pp. lower than expected in the 2003 update, resulting in a positive base effect for 2004. Since the GDP growth forecast remained unchanged between both updates, the deviation totalling 0.6 % of GDP cannot be attributed to negative surprises in GDP growth.

However, part of the shortfall can be explained by a tax-unfriendly growth composition because private consumption grew by 0.4 pp. less than expected by the previous update, resulting in VAT shortfalls. Furthermore, the profit of the central bank turned out 0.1 % of GDP lower than in the budgetary plans. Thus, government revenues are now projected to decline by 0.8 % of GDP in 2004, 0.2 pp. more than foreseen in the 2003 update of the stability programme.⁴

More importantly, the 2004 update estimates that the expenditure ratio was reduced by only 0.6 pp. between 2003 and 2004, compared with a year-on-year reduction by 1.2 pp. in the 2003 update.⁵ A major factor for the overspending was the additional investment premium (*Investitionszuwachsprämie*). This measure was taken up by businesses to a much larger extent than expected by the authorities, resulting in additional expenditure of about ¼ % of GDP.

The non-achievement of deficit targets is due to the fact that all levels of government performed worse than targeted in the 2003 update. According to the 2004 update, the federal level fell short of its target by 0.3 per cent of GDP, as did the state and local levels. This indicates that all levels were affected by the tax shortfalls, but also that expenditure targets were missed across the board. As the investment subsidy is granted as a tax allowance on joint taxes for all levels of government, overspending on this measure increases expenditure also at lower levels of government.

⁴ This is at variance with the statement made in the 2004 update, namely that the total net revenue shortfall amounted to 0.5 % of GDP. The difference is explained essentially by the attribution of the additional investment premium as revenue reducing measure in the update's text (but apparently not in the tables). A consistent and correct treatment according to ESA95 would have had to include this kind of tax allowances among expenditure.

⁵ Due to a statistical revision of the GDP series, the revenue and expenditure shares are not comparable for a given year between different updates. However, the difference in the share between two years for a given update remains comparable with that of another update.

4. BUDGETARY TARGETS AND THE MEDIUM-TERM PATH OF THE PUBLIC FINANCES

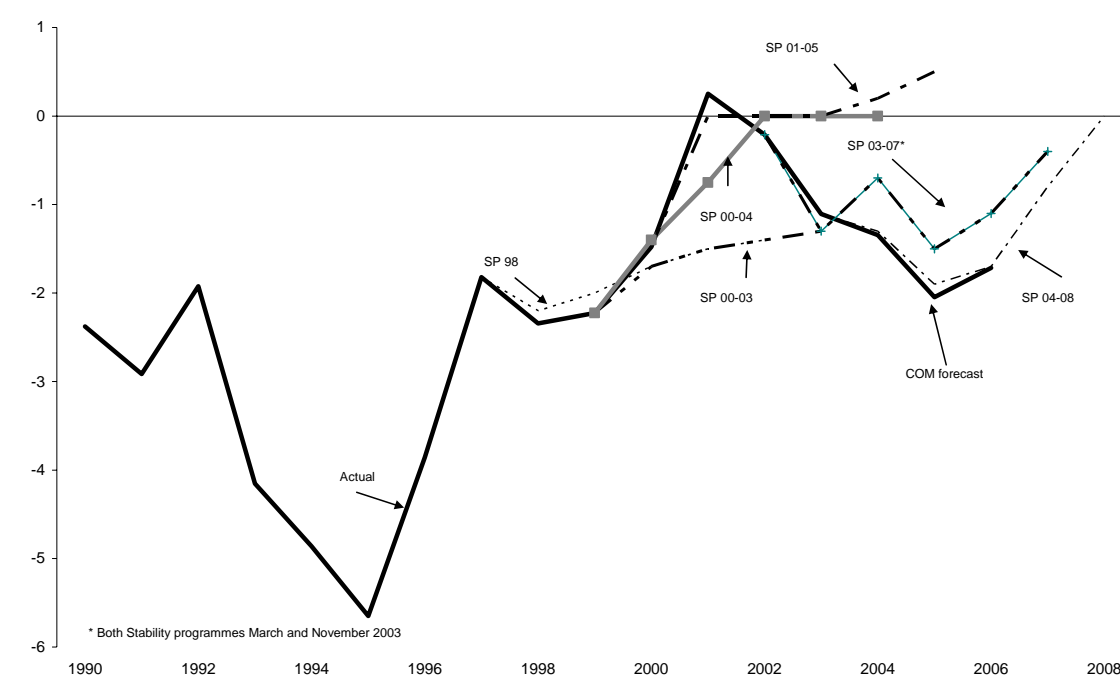
4.1. Evolution of budgetary targets in successive programmes

Table 3 presents the adjustment path envisaged by the authorities in the most recent update in order to reach a balanced budget by 2008 and compares it with the paths in previous updates.

To begin with, the target of a balanced budget has been postponed to the future in successive stability programme updates. While the November 2001 update envisaged a balanced budget already for 2002 and surpluses thereafter, the updates of March and November 2003 postponed consolidation further. The recent update postpones consolidation yet another time, as the budgetary strategy puts the emphasis on tax reductions that are deliberately not financed simultaneously. This implies also that the target of reaching a close-to-balance position has been moved back by one year to 2008 (Table 5).

It should be noted that the revenue and expenditure shares in GDP are not comparable between the 2004 update and earlier updates due to changes in the method of calculating GDP by Statistics Austria.⁶ This change increases the level of nominal GDP by 1-2 % for each year, so that comparisons of the planned adjustment paths between programme updates should be regarded with some caution. The impact on the deficit ratio is negligible, but the revenue and expenditure shares as well as the debt ratio are reduced.

Figure 1: Budgetary adjustment projected by different vintages of programme updates



Source: Stability programmes, Commission services.

⁶ In particular this involves a new method of calculation of the financial intermediation services indirectly measured (FISIM). Following a Eurostat regulation, this new method is compulsory for all member states from 2005 on. Statistics Austria already introduced this change in October 2004.

The 2004 update projects the general government deficit for the years 2004-2007 to be larger by 0.4-0.6 pp. compared with the previous updates of March and November 2003. Despite the weaker-than-expected budgetary position in 2004, the most recent update projects an accelerated reduction in both the revenue and the expenditure shares over the programme horizon. Over the four-year period 2003-2007, the March 2003 update projected a reduction in the revenue share by 1.7 pp. and in the expenditure share by 2.6 pp. With almost identical GDP growth rates, the November 2003 update projected a reduction in the revenue share by 2.6 pp. and in the expenditure share by 3.5 pp. over that period of time. Again, with little change in real GDP growth, the most recent update projects a reduction in the revenue share by 3.5 pp. and in the expenditure share by 3.9 pp. over 2003-2007. The reduction in the revenue share will mostly take place in 2005 and 2006 (2.5 pp. in total), with the implementation of the tax reform. The expenditure share over the same period is reduced by 2pp., of which the largest part falls into 2006. In 2007 and 2008, the budgetary consolidation is projected to take place. The revenue share would fall by 0.4 pp. in total, while the expenditure share is projected to be reduced by even 2.2 pp. over the same period.

Table 3: Evolution of budgetary targets in successive programmes

		2003	2004	2005	2006	2007	2008
General government balance (% of GDP)	SP November 2004	-1.1	-1.3	-1.9	-1.7	-0.8	0.0
	SP November 2003	-1.3	-0.7	-1.5	-1.1	-0.4	-
	<i>SP March 2003</i>	<i>-1.3</i>	<i>-0.7</i>	<i>-1.5</i>	<i>-1.1</i>	<i>-0.4</i>	-
General government expenditure (% of GDP)	SP November 2004	50.6	50.0	49.5	48.0	46.7	45.8
	SP November 2003	51.9	50.7	50.0	49.4	48.4	-
	<i>SP March 2003</i>	<i>52.4</i>	<i>51.6</i>	<i>51.0</i>	<i>50.5</i>	<i>49.8</i>	-
General government revenues (% of GDP)	SP November 2004	49.5	48.7	47.5	46.2	46.0	45.8
	SP November 2003	50.6	50.0	48.5	48.3	48.0	-
	<i>SP March 2003</i>	<i>51.1</i>	<i>50.8</i>	<i>49.5</i>	<i>49.4</i>	<i>49.4</i>	-
Real GDP (% change)	SP November 2004	0.8	1.9	2.5	2.5	2.2	2.4
	SP November 2003	0.9	1.9	2.5	2.5	2.4	-
	<i>SP March 2003</i>	<i>1.4</i>	<i>2.0</i>	<i>2.5</i>	<i>2.5</i>	<i>2.4</i>	-
<i>Sources:</i> <i>Stability programmes (SP)</i>							

4.2. Budgetary targets in the updated programme

The update describes the budgetary strategy as “three-pronged”: First, it aims at a balanced budget over the economic cycle. The update projects to achieve a balanced budget in nominal terms (and also in cyclically-adjusted terms) eventually by 2008. Second, the budgetary strategy targets the tax burden at 40 % of GDP by 2010. According to the update, the tax burden (excluding imputed social security contributions) is projected at 40 % of GDP already in 2008, which may be also helped by the aforementioned upward statistical correction of the GDP series. Third, private investment in research (by using tax incentives), education and infrastructure is to be fostered.

In 2004, the different levels of government in Austria agreed on a new fiscal revenue sharing scheme (*Finanzausgleich*) and on a national stability pact, which allocates the adjustment path of the general government deficit to the different levels of government

from 2005 to 2008 (see Box 2). The update of the stability programme thus takes this allocation as given. The *Länder* collectively are committed to run budget surpluses, which increase slightly over the programme period. Although the *Länder* collectively have run budget surpluses already in the past (though in 2004 lower than expected), the update's projection is not based on a no-policy change scenario for the *Länder* (see below). The national stability pact allocates most of the consolidation effort to reach a balanced budget in 2008 to the federal level, which is committed to reduce its deficit by 1.45 pp. in 2007 and 2008, while other levels of government only contribute ¼ pp.

In short, the consolidation strategy put forward in the update front-loads tax relief, but back-loads the corresponding restraint on expenditure. Between 2004 and 2006, the revenue share is projected to fall by 2.5 pp., while the expenditure share is expected to fall by 2.0 pp. Accordingly, the projected deficit rises to 1.9 % of GDP (2.0 % according to the Commission services autumn forecast) in 2005 from 1.3 % in 2004 and to 1.7 % of GDP in 2006 (in line with the Commission services autumn forecast). In the final years of the programme period, the expenditure share is projected to drop by a further 2.2 pp., while the revenue share is expected to fall by less than ½ pp.

The revenue path is credible in so far as it is driven by already legislated measures, which are detailed in the update. In 2005, the tax reform will result in a budgetary shortfall of €2.1 bn, equalling about 1 % of GDP. Due to lag effects from lowering the corporate tax rate in 2005, an additional revenue reduction is projected for 2006, with little change in 2007 and 2008.

Box 1: The budget for 2005

The main measure in the budget for 2005 consists of the implementation of the second stage of the tax reform 2004/2005. The personal income tax is reduced to four tax brackets, including a zero tax bracket up to an income of €10 000. The corporate tax rate is reduced from 34% to 25%, in addition tax rules for holdings (domestic and foreign) are simplified. The agricultural sector is exempted from mineral oil tax. The burden on the budget will amount to 1 % of GDP.

The health care reform in the context of the Fiscal Revenue Sharing Act is projected to lead to additional revenues of 0.12 % of GDP, mainly due to an increase in the contribution rate by 0.1 pp. and an increase in the tobacco tax. Administrative reforms in the health system are expected by the government to lead to expenditure savings of the same size.

About half of the large expenditure reduction between 2004 and 2008 is projected to arise in the subcategory “social transfers” (-2.0 pp), while the remaining expenditure adjustment is projected to fall into the categories “collective consumption” and “subsidies” (-0.6 pp each) and “other”, which includes transfers such as contributions to the EU and capital transfers such as tax subsidies to households to promote fully-funded pension schemes (Table 4).

Table 4: Composition of the budgetary adjustment

(% of GDP)	2003	2004	2005	2006	2007	2008	Change: 2008-2004
Revenues	49.5	48.7	47.5	46.2	46.0	45.8	-2.9
<i>of which:</i>							
- Taxes and social security contributions	44.3	43.9	42.7	41.5	41.4	41.2	-2.7
- Other (residual)	5.2	4.8	4.8	4.7	4.6	4.6	-0.2
<i>p.m. Tax burden according to ESA¹</i>	43.1	42.7	41.6	40.5	40.3	40.0	-2.7
Expenditure	50.6	50.0	49.5	48.0	46.7	45.8	-4.2
<i>of which:</i>							
- Primary expenditure	47.4	46.8	46.4	44.9	43.7	42.9	-3.9
<i>of which:</i>							
Gross fixed capital formation	1.2	1.2	1.1	1.1	1.0	0.9	-0.3
Collective consumption	6.9	7.0	6.8	6.6	6.5	6.4	-0.6
Social transfers	29.6	29.4	29.0	28.4	28.0	27.4	-2.0
Subsidies	3.2	3.0	3.1	2.8	2.7	2.4	-0.6
Other (residual)	6.4	6.3	6.3	6.0	5.5	5.8	-0.5
- Interest payments	3.2	3.2	3.1	3.1	3.0	2.9	-0.3
Budget balance	-1.1	-1.3	-1.9	-1.7	-0.8	0.0	
Primary balance	2.1	1.9	1.2	1.3	2.2	2.9	
<i>Note:</i>							
¹ Taxes and security contributions excl. imputed social security contributions and incl. inheritance taxes.							
<i>Sources:</i>							
Stability programme update; Commission services calculations							

“Social transfers” comprise pension, health care, unemployment benefits and education. Under the pre-2003 situation, the expenditure share for public and private pensions would have risen by 0.9 pp between 2005 and 2015.⁷ Following the recent reforms of 2003 and 2004, the pension share in GDP should remain constant between 2005 and 2015.⁸ The measures concerning the public health system included in the fiscal revenue sharing agreement of 2004 provide for some administrative reforms intended to lower costs and higher co-payments by patients, which may provide incentives to economise on health care consumption leading to estimated cost savings of €300m, i.e. about 0.12 % of GDP annually until 2008. Nonetheless, health expenditure is projected to increase by 0.3 pp until 2015 (Table 7 of the update). Moreover, the two largest health care measures taking effect in 2005 concern in fact revenues (an increase in social contributions by 0.1 pp. until 2008 and an increase in the tobacco tax). Some easing in the social transfer expenditure ratio may be achieved by an improvement in the labour market as a consequence of the assumed buoyant GDP growth. The programme does not detail the path of education expenditure. In sum, further measures seem necessary to achieve the envisaged reduction in the transfer share in GDP. Nonetheless, without recent reforms it would have even increased.

The envisaged savings in the category “collective consumption” assume a restrictive stance for expenditure on wages and employment in the public sector, which up to 2006

⁷ See the 2001 update of the stability programme of Austria, Table 6.

⁸ See also Pensionsharmonisierungsgesetz 2004: 653 der Beilagen XXII. GP - Regierungsvorlage – Materialien, Table C/2. Available at:
http://www.parlament.gv.at/pls/portal/docs/page/PG/DE/XXII/I/I_00653/fname_028381.pdf

was also an assumption included in the Commission services forecast. The update assumes that this restrictive policy will be continued after 2006. Furthermore, the update assumes that lower levels of government would accomplish similar savings on public employment to those the federal level achieved over the last years (about €1bn expected until 2008).⁹ Furthermore, savings are expected from the implementation of the proposals by the Austrian Constitutional Convention (*Österreich-Konvent*) on an overhaul of the constitution in order to achieve a more efficient government. The assumed amounts are not detailed in the update.

The projected reduction in subsidy expenditure is markedly back-loaded. While the expiry of the subsidy to additional investment in 2005 will reduce expenditure by about 0.3 % in GDP in 2006 (due to the method of accounting), the update does not detail how the further reduction by 0.4 % of GDP between 2007 and 2008 is to be achieved.

The envisaged expenditure reduction in the category “other” is substantial, but unfortunately not detailed in the update. Since it is a residual category, it is difficult to predict.

Box 2: The National Stability Pact in Austria

The three layers of government in Austria coordinate their medium-term budgetary plans in the Revenue Sharing Act (*Finanzausgleich*), usually for a period of four years, which allocates the joint revenues to territorial authorities.¹⁰ The 1999 national stability pact (NSP) set up an enforcement mechanism on how the general government deficit was to be allocated to the different levels of government. A more detailed NSP was passed for the period 2001-2004, temporarily suspending the 1999 NSP.

This 2001 NSP foresaw a consolidation path leading to a balanced budget of general government in 2002-2004, for which deficit targets (so-called “stability contributions”) are allocated to the federal, state and local levels of government, flanked by a sanctioning mechanism.

National Stability Pact 2001-2004, budgetary targets and results, % of GDP

Level	2001			2002			2003			2004	
	NSP target	outcome adj.	(unadj.)	NSP target	outcome adj.	(unadj.)	NSP target	outcome adj.	(unadj.)	NSP target	outcome (unadj.)
Gen.gov.	-1.3	0.7	(0.3)	0.0	0.4	(-0.2)	0.0	-0.6	(-1.1)	0.0	(-1.3)
Federal	-2.05	-0.2	(-0.5)	-0.75	-0.5	(-0.9)	-0.75	-1.4	(-1.7)	-0.75	(-1.7)
Lower	0.78	0.9	(0.8)	0.76	0.9	(0.7)	0.75	0.8	(0.6)	0.75	(0.4)
Soc.sec.	n.a.	n.a.	(0.0)	n.a.	n.a.	(0.0)	n.a.	n.a.	(0.0)	n.a.	(0.0)

Note: Explanation in the text. Figures may not add up due to rounding.

Source: Federal Ministry of Finance on data by Statistics Austria.

The table shows the budgetary evolution during the 2001 NSP. The column “NSP target” lists the budgetary balance targets in % of GDP given in the 2001 NSP. “Outcome (unadj.)” shows the ex-post budgetary outcome according to the updates of the stability programme. However, this is subject to two adjustments before compliance with the NSP target is assessed. First, the NSP is fixed in terms of ESA95 as of October 2000. Second, revised deficit targets can be negotiated between the governments in case of an exceptional burden, in particular revenue shortfalls and

⁹ Additional information provided by the Ministry of Finance on 10 December.

¹⁰ A. Matzinger: “Finanzausgleich”, in: G. Steger (ed.), *Öffentliche Haushalte in Österreich*, Wien 2002: 51 – 94.

expenditure increases due to a severe economic slowdown. These exceptional circumstances are not specified more precisely in the NSP. The column “outcome adj.” shows the budgetary outcome adjusted in such way, according to the Austrian authorities.

The federal budget for 2003 may be illustrative. The NSP targeted the deficit at 0.75% of GDP. The deficit according to the 2004 update of the stability programme amounted to 1.7% of GDP. Thus the difference between the federal deficit reported in the stability programme update and the NSP target equalled 0.95 pp. The actual deficit was adjusted down to 1.4% of GDP by property sales, which are not considered as deficit-reducing by a Eurostat decision made only after October 2000, and by exceptional expenditure related to the floods of 2002. The difference between the target of 0.75% and the adjusted outcome now implies a shortfall from the NSP target of 0.65 pp.

However, the NSP foresees a further margin of tolerance. For the federal level, an (approx.) 0.25 pp deviation from a given year’s target is acceptable and may be offset in future years. Thus, after the acceptable tolerance for 2003 the shortfall from the target is reduced to 0.4 pp.

Compliance with the NSP might however be understood that the required stability contribution should be respected only on average over the pact’s duration. The average of the federal targets (columns “NSP target”) for the four years amounts to 1.1% of GDP. The average of the adjusted outcomes from 2001 to 2004 (columns “outcome adj.” 2001-03 and “outcome (unadj.)” for 2004) equals 0.95% of GDP, which would imply that on average, the targets would have been met. In effect, this calculation implies that the better-than-required adjusted outcome in 2001 would ensure compliance, even though the federal deficit in all subsequent years exceeded the NSP target.

However, it is doubtful whether the favourable outcome of 2001 can be carried over to later years in this way. The notes accompanying the NSP law seem to rule this out.¹¹ Then, indeed, for 2003 the sanctioning mechanism might be invoked. Upon a report by the Court of Auditors, a mediation committee consisting to equal parts of federal and Länder/local government representatives needs to decide unanimously by February in the second year after the violation whether sanctions are due. The NSP fixes the amount of the sanction, which takes the form of an interest-bearing deposit. If in the following year the respective target is not reached, the deposit is transferred to those governments in compliance, and reimbursed otherwise.

Thus it may indeed be the case that for 2003, the federal level might have exceeded the tolerable deficit by the 0.4 pp calculated above. The 2004 report of the Court of Auditors is silent on the fulfilment. This may suggest that, according to the NSP, a decision by the mediation committee is being prepared for February 2005. It cannot be excluded that the mediation committee invokes further exceptional burdens to the 2003 budget, which would adjust the deficit outcome (column “outcome adj.”) further below 1.4% of GDP. Moreover, in the 2004 federal budget again a deficit exceeding the target is planned (1.7% as opposed to 0.75% of GDP). In the most unfavourable case, a mediation committee would have to decide by February 2006. Nothing, however, is publicly known, whether such a mediation committee will convene. The NSP law does not specify publication obligations regarding the sanctioning mechanism.

The 2005 NSP concluded for the years 2005-2008, which is the baseline for the 2004 update of the stability programme, resembles very much the 2001 NSP. For 2005 and 2006, only the ESA accounting rules as of October 2000 continue to be applicable. However, the 2005 NSP does not foresee a tolerance margin for exceeding the deficit target by 0.25% of GDP for the years 2005 and 2006, but only for 2007 and 2008. The recent update of the stability programme takes the targets of the 2005 NSP at face value. In particular, the 2005 NSP targets the general government to be balanced by 2008. However, given the room for manoeuvre that the NSP seems to offer, substantial deviations may be possible before the NSP becomes binding.

¹¹ 829 der Beilagen XXI. GP, Materialien – Regierungsvorlage Stabilitätspakt 2001-2004, available at www.parlament.gov.at. See also A. Matzinger, *op. cit.*, para. 9.4.3.; and L. Diebalek, W. Köhler-Töglhofer, D. Prammer: *The Austrian Internal Stability Pact – its Effectiveness Revisited*, preliminary paper presented at the Workshop on Fiscal Rules, Madeira, 9-10 December 2004.

The ambitious consolidation path is not sufficiently detailed in the update. Therefore, the credibility of the back-loaded consolidation path projected in the update hinges on the effectiveness of the 2005-2008 National Stability Pact. The 2005-2008 agreement is the third national stability pact concluded in Austria. Like the current pact (2001-2004), it spells out a monitoring and sanctioning mechanism between the levels of government. The analysis in Box 2 suggests that the experience with the current pact offers only limited help to determine whether the successor's main target, the balanced budget by 2008, is backed up by strict enforcement. The NSP rules seem to provide some room for adjusting the statistics and invoking exceptional circumstances - without strict publication requirements - before the pact becomes binding. Indeed, whether the 2001-2004 national stability pact has been respected, will not be known before August 2005, when the Austrian statistical office will have finalised the national accounts; perhaps even not before February 2006, when the mediation committee (if necessary) would have come to a decision. It may turn out that the 2001-2004 NSP has been formally complied with, although targets have been widely missed.

The new NSP (2005-2008) certainly provides incentives to respect the ambitious consolidation path until 2008. However, like its predecessor it leaves room for interpretation and postponing consolidation to later years before it becomes binding. Nonetheless, it remains a remarkable exception in the EU that Austria has legally enshrined ambitious budgetary commitments across various levels of government. That said, it would have been welcome if the update had evaluated the National Stability Pact currently in force for its first three years of existence.

In sum, the general government deficit is projected to remain sufficiently below the Maastricht-ceiling of 3 % of GDP throughout the programme period. At face value, the budgetary stance in the programme also seems sufficient to achieve the medium-term objective in the Stability and Growth Pact of a budgetary position of close-to-balance at the very end of the period, namely in 2008. Moreover, the budgetary stance should, throughout the programme period, leave a sufficient safety margin against breaching the 3 % of GDP deficit threshold within normal cyclical fluctuations.¹²

However, the budgetary path projected in the update seems plausible only for the years 2005 and 2006, when it is based on legislated measures, notably the tax cuts. The back-loaded consolidation in the later years, 2007 and 2008, is ambitious and does not seem fully substantiated by the policy measures discussed in the update. The incomplete implementation of envisaged expenditure targets remains the main risk to the budgetary strategy, as has been stressed already in the assessments of previous updates. Such risks are enhanced by the somewhat optimistic growth scenario for 2007/8.

This leaves fiscal policies as reflected in the update only partly consistent with the country-specific recommendations in the Broad Economic Policy Guidelines in the area of public finances. Specifically, the cyclically-adjusted balance deteriorates in 2005 and improves only marginally in 2006, so that a cyclically-adjusted budgetary position close to balance is only attained in 2008. While the planned reduction of the high tax burden is in itself an appropriate step to render supply side conditions more growth-friendly, revenue reductions should be accompanied by corresponding expenditure restraint, as requested in the guidelines addressed to Austria. As concerns especially the years 2007

¹² The minimum benchmark of a cyclically-adjusted deficit at 2.1 % of GDP in Austria is unusually high compared with other EU countries.

and 2008, the “structural expenditure savings, (also) at lower levels of government”, are part of the budgetary strategy projected in the update and are enshrined in the National Stability Pact. However, the budgetary stance in the programmes is not sufficiently detailed to determine whether the ambitious steps in these two years can indeed be achieved.

Table 5: Output gaps and cyclically-adjusted (primary) balances (CA(P)B)⁴

	2004		2005		2006		2007	2008	Change: 2008-2004
	COM	SP ¹	COM	SP ¹	COM	SP ¹	SP ¹	SP ¹	SP ¹
Budget balance ²	-1.3	-1.3	-2.0	-1.9	-1.7	-1.7	-0.8	0.0	1.3
Output gap ^{1,3}	-1.1	-1.3	-0.6	-0.8	-0.2	-0.3	-0.1	-0.2	1.1
CAB ^{1,2}	-1.0	-0.9	-1.9	-1.7	-1.7	-1.6	-0.8	-0.1	0.9
CAPB ^{1,2}	2.0	2.3	1.1	1.4	1.3	1.5	2.2	2.8	0.5
Notes: ¹ SP (stability programme) Commission services calculations on the basis of the information in the programme ² in percent of GDP ³ in percent of potential GDP Sources: <i>Commission services autumn 2004 economic forecasts (COM); Commission services calculations</i>									

4.3. Sensitivity analysis

The update presents two alternative scenarios to the baseline, both assuming a specific growth profile instead of mechanically adding a standard shock to baseline GDP growth. The programme does, however, not substantiate the specific deviations from the baseline growth pattern.¹³ As for the results, in the lower growth scenario the achievement of a balanced general budget would be postponed until 2009, while in the optimistic scenario this target would already be hit in 2007. Even under the pessimistic scenario, the deficit would only in 2005 and 2006 be above 2% of GDP.

In order to assess the plausibility of these results, Commission services have carried out an additional sensitivity analysis under the assumptions of (i) a sustained ± 0.5 pp. deviation from the growth targets in the programme baseline over the 2005-2008 period; (ii) trend output based on the HP-Filter and (iii) no policy response (i.e. the expenditure level being as in the central scenario). The outcome regarding the general budget balance is quite similar to the update’s simulation results, in that the target date for a balanced budget would be moved forward (postponed) by one year in the upside (downside) scenario, and in that there is no significant risk of breaching the 3 % limit in the downside scenario. By 2008, the cyclically-adjusted balance 0.7 pp. below the central scenario. Hence, in the case of persistently lower growth, additional measures of around 0.7 % of GDP would be necessary to keep the public finances on the path targeted in the central scenario.

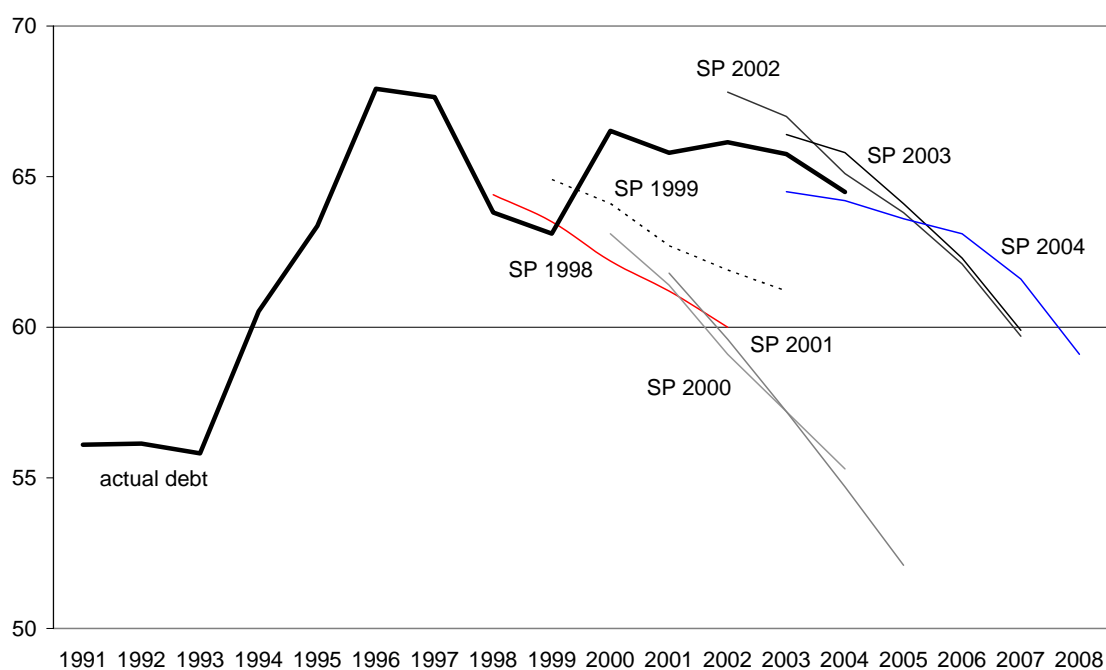
¹³ In addition, interpreting the upward and the downward scenario as upper and lower bounds of a “confidence interval” around the baseline scenario, the narrowing interval would suggest a decrease in forecast uncertainty over the forecast horizon, which would be counterintuitive.

5. EVOLUTION OF THE DEBT RATIO

The debt-to-GDP-ratio for 2004 turns out to be lower than projected in the previous update of the stability programme. This is the result of a simultaneous downward revision of the debt figures and an upward revision of the GDP figures. These revisions do not significantly affect the year-to-year changes in the ratio, but lower the starting base in 2003 by 2 pp. to 64.5 % of GDP. Although growth in 2004 is in line with expectations of the previous programme, the debt reduction in 2004 fell short of plans by 0.6 pp. as a result of deterioration in the deficit.

The most recent update of the stability programme expects the debt ratio to fall below the 60 % reference value in 2008. Despite the better starting base this implies that the date for reducing the debt ratio below the reference value was moved back by one year, because the adjustment speed for the debt reduction between 2003 and 2007 slowed from 6½ pp. to 3 pp. The much less ambitious debt reduction plan is near exclusively due to higher net deficits throughout the programme period. Contributions from interest payments and nominal GDP growth will not change much over the programme period.

Figure 2: Debt projections in different vintages of programme updates



Source: Stability programmes; Commission services

Despite the slower consolidation, the debt ratio falls throughout programme period following an adjustment that is very close to that of the Commission services autumn forecast. However, as in the previous update, debt reduction plans are very ambitious in the final two years. This back loading poses a significant risk that the target in 2008 will not be reached. The target will also not be reached in a low growth scenario. By way of positive risk, the update does not include the full potential of privatisations in Austria, which could reach up to 1 % of GDP in 2007 and 2008.

Table 6: Debt dynamics

	average 2000-2003	2004		2005		2006		2007	2008
	COM	COM	SP	COM	SP	COM	SP	SP	SP
Government gross debt ratio	66.4	64.0	64.2	63.9	63.6	63.4	63.1	61.6	59.1
Change in debt ratio (1 = 2+3+4)	-0.6	-1.1	-0.3	-0.1	-0.6	-0.4	-0.5	-1.5	-2.5
<i>Contributions:</i>									
- Primary deficit (2)	-2.7	-1.7	-1.9	-0.9	-1.2	-1.2	-1.4	-2.2	-2.9
- “Snow-ball” effect (3)	1.2	0.6	0.6	0.8	0.4	0.7	0.6	0.7	0.4
- Interest expenditure	3.3	3.1	3.2	3.0	3.1	2.9	3.1	3.0	2.9
- Real GDP growth	-1.0	-1.2	-1.2	-1.5	-1.5	-1.5	-1.5	-1.3	-1.4
- Inflation (GDP deflator)	-1.2	-0.8	-1.4	-0.7	-1.1	-0.8	-0.9	-1.0	-1.1
- Stock-flow adjustment (4)	0.9	0.0	0.5	0.1	0.2	0.1	0.3	0.0	0.0
- Cash/accruals	0.0	0.0		0.0		0.0			
- Accumulation of financial assets	1.3	0.0		0.0		0.0			
of which: Privatisation proceeds	-0.5	0.0	0.4	0.0	0.2	0.0	0.3	0.0	0.0
- Valuation effects & residual adj.	-0.4	0.0		0.0		0.0			
Note: 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. Sources: <i>Stability programme update (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations</i>									

The Austrian debt ratio has been exceeding the 60 % of GDP reference value since 1999. A tentative assessment of the pace of debt reduction over a medium-term horizon is presented in figure 3. It compares the projections for the debt ratio in each year of the programme (starting from the projection for 2004) with the values obtained for the same year by applying an illustrative “rolling debt reduction rule”. This rule describes a minimum reduction in the debt ratio over the previous five/four/three-year period; for example, the projection for 2004 is compared with the values obtained for the same year by applying the formula over the periods 1999-2004, 2000-2004 and 2001-2004¹⁴. If the

¹⁴ The “rolling debt reduction rule” in the graph is shown for successive five-year periods through a recursive application of the formula:

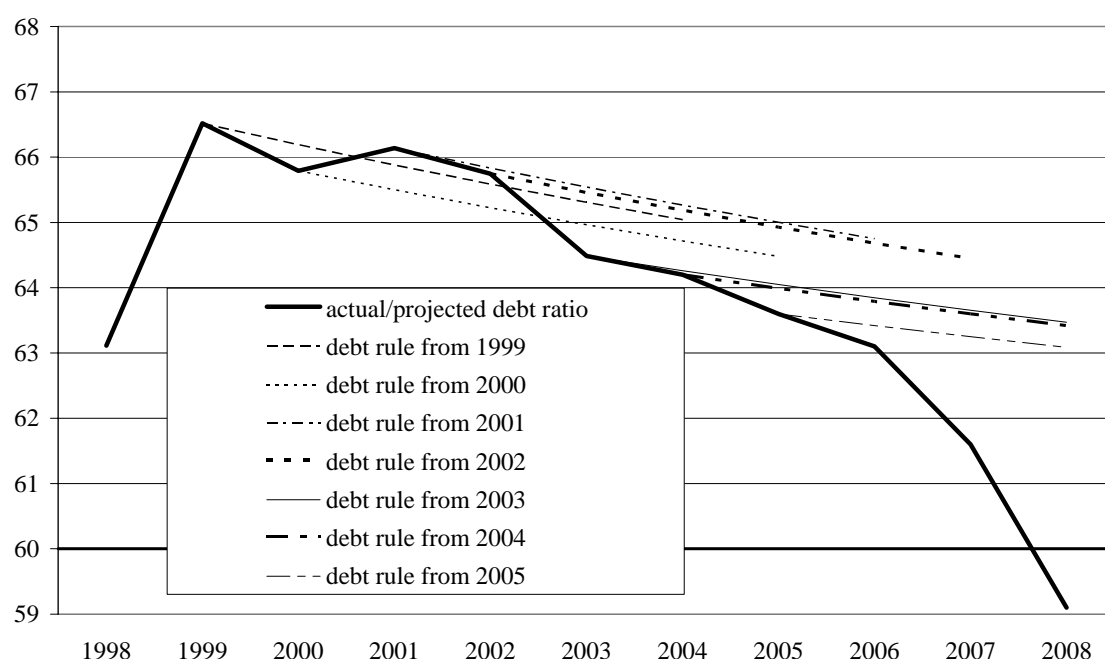
$$\left(\frac{D_t}{Y_t} \right)_{rule} = 0.05 * \left[60 - \left(\frac{D_{t-1}}{Y_{t-1}} \right)_{rule} \right] + \left(\frac{D_{t-1}}{Y_{t-1}} \right)_{rule}$$

where t is a time subscript and D and Y are the stock of government debt and nominal GDP, respectively (note that, in the first year of the five-year period, the debt ratio in the previous year is the actual debt ratio). The change in the debt ratio can be decomposed as follows (assuming that the stock-flow adjustment is equal to zero):

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

debt levels projected in the programme exceed those obtained by applying the rule, this is taken as an indicator of a slow reduction in the debt ratio. This is consistent with the idea that the minimum debt reduction should be ensured not year after year but over a medium-term horizon. It can be seen that the debt ratio is planned in the update to diminish over the entire programme period by more than implied by the rolling debt reduction rule.

Figure 3: Rolling debt rule



Source: Commission services

6. STRUCTURAL REFORM AND THE QUALITY OF PUBLIC FINANCES

The Austrian government plans a significant reduction of the expenditure-to-GDP ratio over the period, namely by 5 pp. between 2003 and 2008. This ambitious reduction is planned to be achieved through significant cut-backs across all expenditure categories throughout the programme period. Nevertheless the expenditure reductions entail some changes in the relative composition of expenditures. “Social transfers” are (optimistically) projected to make the largest contribution to the consolidation. Yet, the projected consolidation path implies that government investment falls more in relation to

where DEF is the government deficit and y represents nominal GDP growth. Noting that $0.05 \cdot 60 = 3$, the formula for the “rolling debt reduction rule” describes the path for convergence of the debt ratio towards the 60 % of GDP debt reference value consistent with a deficit equal to the 3 % of GDP reference value. Consistency is achieved for a nominal GDP growth rate of 5 % of GDP. For nominal GDP growth rates higher than 5 %, the minimum debt reduction rule can be respected with deficits in excess of 3 % of GDP; for nominal GDP growth rates lower than 5 %, respect of the minimum debt reduction rule necessitates deficits lower than 3 % of GDP.

transfer payments, which might indicate a relative worsening of the structure of public finances. These figures underestimate, however, the degree to which transfers are reduced, because without the pension reforms, transfers would have risen significantly. A welcome aspect is that subsidies are also planned to be trimmed back, in part after the effects of temporary investment write-off scheme wear off.

Noteworthy is that the administrative reform has already led to a significant reduction in the number of federal civil servants and thus allows substantial longer-run cost saving. In the update it is expected that administrative reform continues. Similar administrative reforms are assumed in the programme for the Länder and communes. A high level group on constitutional reform is expected to present reform proposals on increase the efficiency of administration across the board, ranging from reallocation of competencies to simplification of rules. The update provides no estimation of expected cost savings. The health care reform could also lead to increased administrative efficiency as a result of introducing a country-wide health care chip card. Small efficiency gains might be expected from mildly higher health care co-payments.

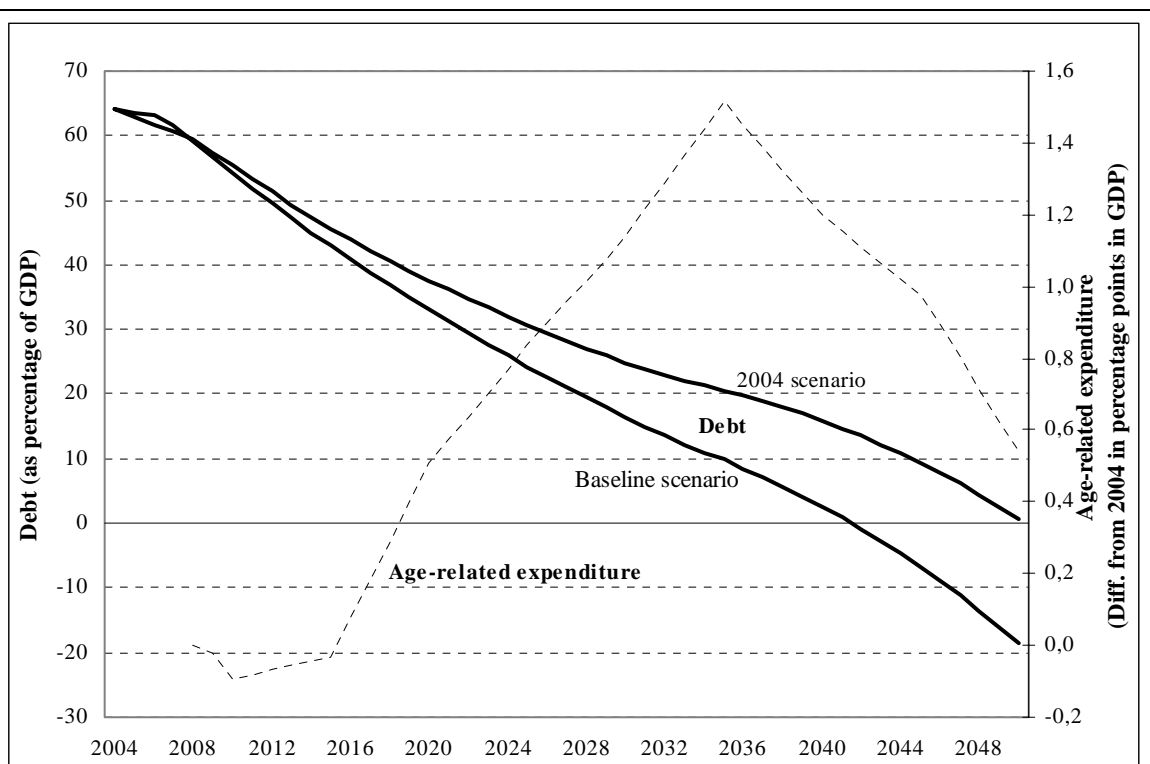
7. THE SUSTAINABILITY OF THE PUBLIC FINANCES

The assessment of the sustainability of the Austrian public finances is based on an overall judgement of the results of quantitative indicators and qualitative features. The quantitative indicators project debt developments according to two different medium-term budgetary scenarios. The “programme” scenario (baseline) assumes that the medium-term objective set in the programme is actually achieved, while the “2004” scenario assumes that the underlying primary balance remains throughout the programme period at the 2004 level (see graph below).

On the basis of the programme and additional information provided in the framework of the exercise conducted by the Economic Policy Committee, age-related expenditure is foreseen to remain broadly constant at its current level between 2008 and 2050 (see Annex 2 for a breakdown of different age-related expenditures). This is due to a strong correction in the dynamics of pension expenditures as a consequence of the 2003 pension reform (for public pensions to private sector employees the 2004 reform, see below, seems to be already included in the data of the update). In the 2001 update of the stability programme, depicting the pre-2003 situation, pension expenditures were expected to reach 18.1% of GDP in 2030. According to the most recent update, expenditure to GDP will fall by a remarkable 3.2 pp. of GDP, underlining the significant reform effort. Gross debt is projected to continuously decrease and to reach negative values by the middle of the century.¹⁵

Figure 4: Long-term sustainability - summary results

¹⁵ It should be recalled that, being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of likely outcomes and should not be taken at face value.



Sustainability indicators

	S1*	S2**	RPB***
Baseline scenario	-1,3	-1,0	1,9
2004 scenario	-1,0	-0,7	1,9

Notes:

* It indicates the required change in tax revenues as a share of GDP over the projection period that guarantees to reach debt to GDP ratio of 60% of GDP in 2050.

** It indicates the required change in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon to the debt as existing at the outset of the projection period.

*** Based on S2, the Required Primary Balance (RPB) indicates the average minimum required cyclically adjusted primary balance as a share of GDP *over the first five years* of the projection period that guarantees the respect of the intertemporal budget constraint of the government.

Source: Commission services

On the basis of the debt projections, it is possible to calculate a set of sustainability indicators to measure the gap between the current policies and a sustainable one. The S1 indicator shows the permanent change in the primary balance that is required to have a debt ratio in line with the 60% of GDP reference value in the very long run (year 2050).¹⁶ S2 shows the gap between the current tax policies and those that would ensure respect of the intertemporal budget constraint given the future impact of ageing on public expenditure, namely the change in the tax ratio that would equate the present discounted value of future primary balances to the current stock of gross debt¹⁷. According to the latter, Austria may lower its tax ratio permanently by around 1 pp. This would lead to a

¹⁶ Respecting the underlying debt path does not ensure sustainability over an infinite horizon, but only that debt remains below 60 % up to 2050. In most cases, this would imply an increasing trend and possible unbalances after the end of the projection period.

¹⁷ Formally, the intertemporal budget constraint assumes that the present discounted value of the ratio of the primary balance to GDP is equal to the negative of the current level of the debt to GDP ratio.

sustainable debt ratio by the middle of this century of close to 40 % of GDP. The budgetary effort over the first 5 years of the projections (i.e. after the end of the programme period) to respect the intertemporal budget constraint would require a primary surplus of 1.9 % of GDP on average, about 1 pp. lower than the one projected for the last year of the programme period.

In interpreting these results, it must be taken into account that, against demographic trends, the update expects pension payments as a share of GDP to increase only moderately by 0.9 pp. between 2005 and 2035 and to decline by 1.5 pp. between 2035 and 2050. The rigorous long-run containment of pension payments is based on a low rise in pension levels and a substantial rise in employment ratios.

After the pension reform of 2003, Austria passed a further pension reform in 2004 (*Pensionsharmonisierung*), with the aim of bringing all groups of private and public sector employees into a harmonised pension system. The significant contribution of the 2004 law to long-term financial sustainability is being back-loaded to take effect only after 2030, while the medium-term savings from the 2003 law are partly reduced.

In the long-term, the 2004 pension reform limits pension increases to merely an inflation adjustment starting in 2006. However, until 2050, parallel pension accounts are maintained in order to limit the losses from inflation indexation compared with the pre-2003 situation. Thus the long-term sustainability calculations are based on the assumption that the political agreement will hold over 45 years. However, having no increase in real pensions, while real incomes increase over the same time period, would be credible only if accompanied by a substantial build-up in complementary pension system. Plans to reform the system of company pensions are under review, but not yet available. It therefore remains to be seen to what degree this can create a sufficient substitute for the government pension system.

Furthermore, the increase in the old-age dependency ratio (measured as the number of persons over the age of 64 per 100 persons aged 20 to 64) foreseen in the update is somehow lower than the one projected by EUROSTAT, with beneficial effects on age-related expenditures.

* * *

Annex 1: Summary tables from the 2004 stability programme update

Table A- 1: Growth and associated factors

		2003	2004	2005	2006	2007	2008
GDP <i>growth at constant</i> market prices (7+8+9)		0,8	1.9	2.5	2.5	2.2	2.4
GDP <i>level at current</i> market prices		226.1	233.5	243.6	253.4	263.1	274.2
GDP deflator		1.6	1.3	1.8	1.5	1.6	1.8
HICP change		1.3	2.1	1.8	1.4	1.5	1.6
Employment growth		--	--	--	--	--	--
Dependent employment*		0.2	0.6	0.9	0.9	0.9	1.1
Labour productivity growth **		0.8	1.4	1.6	1.6	1.3	1.3
Sources of growth: percentage changes at constant prices							
1. Private consumption expenditure		0.6	1.6	2.5	2.9	2.4	2.3
2. Government consumption expenditure		0.4	0.5	0.3	0.3	0.4	0.3
3. Gross fixed capital formation		6.2	2.2	3.5	4.3	3.3	3.1
4. Changes in inventories and net acquisition of valuables as a % of GDP		0.4	-0.3	-0.1	0.0	0.1	0.2
5. Exports of goods and services		1.4	6.0	6.2	6.0	5.5	6.5
6. Imports of goods and services		4.8	4.7	6.4	6.6	5.9	6.5
Contribution to GDP growth							
7. Final domestic demand (1+2+3)		1.9	1.5	2.6	2.7	2.2	2.1
8. Change in inventories and net acquisition of valuables (=4)		0.4	-0.3	-0.1	0.0	0.1	0.2
9. External balance of goods and services (5-6)		-1.4	0.8	0.0	-0.2	-0.1	0.1
Basic assumptions							
Short-term interest rate (annual average)		2.3	2.1	2.6	3.2	3.0	3.0
Long-term interest rate (annual average)		4.2	4.2	4.6	4.8	4.9	4.9
USD/€ exchange rate (annual average)		0.89	0.81	0.80	0.78	0.75	0.75
(for non-euro countries) exchange rate vis-à-vis the € (annual average)		4.2	5.7	4.8	4.6	5.0	5.0
World excluding EU.GDP growth		0.8	2.5	2.3	2.4	2.2	2.4
EU-15 GDP growth		-	9.0	7.9	7.3	7.0	8.0
Growth of relevant foreign markets		10.3	11.6	8.8	8.3	8.0	9.0
World import volumes. excluding EU		32.2	39.3	35	35	35	35
Oil prices		2.3	2.1	2.6	3.2	3.0	3.0

* According to social security statistics. i.e. including persons on parental leave

** calculated on basis of effective labour force

Table A- 2. General government budgetary developments

% of GDP		2003	2004	2005	2006	2007	2008
Net lending by sub-sectors							
1. General government		-1.1	-1.3	-1.9	-1.7	-0.8	0.0
2. Central government		-1.7	-1.7	-2.4	-2.2	-1.4	-0.75
3. State government		0.5	0.3	0.4	0.4	0.5	0.55
4. Local government		0.2	0.1	0.2	0.2	0.2	0.2
5. Social security funds		0.0	0.0	-0.1	-0.1	-0.1	0.0
General government							
6. Total receipts		49.5	48.7	47.5	46.2	46.0	45.8
7. Total expenditures		50.6	50.0	49.5	48.0	46.7	45.8
8. Budget balance		-1.1	-1.3	-1.9	-1.7	-0.8	0.0
9. Net interest payments		3.2	3.2	3.1	3.1	3.0	2.9
10. Primary balance		2.1	1.9	1.2	1.3	2.2	2.9
Components of revenues							
11. Taxes		28.0	27.7	26.8	25.9	25.8	25.6
12. Social contributions		16.3	16.2	15.9	15.6	15.6	15.6
13. Interest income		5.2	4.8	4.8	4.7	4.6	4.6
14. Other		49.5	48.7	47.5	46.2	46.0	45.8
15. Total receipts		43.1	42.7	41.6	40.5	40.3	40.0
Components of expenditures							
16. Collective consumption		6.9	7.0	6.8	6.6	6.5	6.4
17. Social transfers in kind		10.9	10.7	10.4	10.1	9.9	9.6
18. Social transfers other than in kind		18.7	18.7	18.6	18.3	18.1	17.8
19. Interest payments		3.2	3.2	3.1	3.1	3.0	2.9
20. Subsidies		3.2	3.0	3.1	2.8	2.7	2.4
21. Gross fixed capital formation		1.2	1.2	1.1	1.1	1.0	0.9
22. Other		6.4	6.3	6.3	6.0	5.5	5.8
23. Total expenditures		50.6	50.0	49.5	48.0	46.7	45.8

Table A- 3. General government debt developments

% of GDP		2003	2004	2005	2006	2007	2008
Gross debt level		64.5	64.2	63.6	63.1	61.6	59.1
Change in gross debt		-1.3	-0.3	-0.6	-0.5	-1.5	-2.5
Contributions to change in gross debt							
Primary balance		-2.1	-1.9	-1.2	-1.3	-2.2	-2.9
Interest payments		3.2	3.2	3.1	3.1	3.0	2.9
Nominal GDP growth		-1.5	-2.1	-2.7	-2.6	-2.4	-2.5
Other factors influencing the debt ratio		-0.9	0.5	0.2	0.3	0.0	0.0
Of which: Privatisation receipts							
p.m. implicit interest rate on debt		5.0	5.0	4.9	4.9	4.9	4.9

Table A- 4. Cyclical developments

% of GDP	2003	2004	2005	2006	2007	2008
1. GDP growth at constant prices	0.8	1.9	2.5	2.5	2.2	2.4
2. Actual balance*	-1.1	-1.3	-1.9	-1.7	-0.8	0.0
3. Interest payments	3.2	3.2	3.1	3.1	3.0	2.9
4. Potential GDP growth **	2.0	2.0	2.0	2.0	2.1	2.1
5. Output gap	-1.3	-1.4	-0.9	-0.4	-0.3	0.0
6. Cyclical budgetary component*	-0.7	-0.7	-0.5	-0.2	-0.1	0.0
7. Cyclically-adjusted balance (2-6)	-0.4	-0.6	-1.5	-1.5	-0.7	0.0
8. Cyclically-adjusted primary balance (7-3)	2.8	2.6	1.6	1.6	2.3	2.9

*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: Statistik Austria; Federal Ministry of Finance.

Table A- 5. Divergence from previous update

% of GDP	2003	2004	2005	2006	2007
GDP growth					
previous update	0.9	1.9	2.5	2.5	2.4
latest update	0.8	1.9	2.5	2.5	2.2
Difference	-0.1	0.0	0.0	0.0	-0.2
Actual budget balance					
previous update	-1.3	-0.7	-1.5	-1.1	-0.4
latest update*	-1.1	-1.3	-1.9	-1.7	-0.8
Difference**	0.2	-0.6	-0.4	-0.6	-0.4
Gross debt levels					
previous update	66.4	65.8	64.1	62.3	59.9
latest update	64.5	64.2	63.6	63.1	61.6
Difference***	-1.9	-1.6	-0.5	0.8	1.7

* including tax reform and SWAP-Operations

** a positive sign denotes an improvement

*** a positive sign denotes a deterioration

Table A- 6. Long-term sustainability of public finances

% of GDP	2005	2010	2020	2030	2050
Total expenditure	49.5	--	--	--	--
Old age pensions	14.2	--	14.6	14.9	13.6
Health care (including care for the elderly)	5.1		5.6	6.0	6.4
Interest payments	3.1	--	--	--	--
Total revenues	47.5	--	--	--	--
of which: from pensions contributions	--	--	--	--	--
National pension fund assets (if any)	--	--	--	--	--
Assumptions					
Labour productivity growth	1.1	--	1.8	1¾	1¾
Real GDP growth**	1.7	--	1.5	14	1.6
Participation rate males (aged 20-64)*	76.7	--	77.2	78.7	81.2
Participation rates females (aged 20-64)*	60.8	--	62.4	64.7	70.1
Total participation rates (aged 20-64)*	68.8	--	69.9	71.8	75.8
Unemployment rate (EU-definition)	4.3	--	3.0	3.0	3.0.

* (Age 15-64) ** (5 year average)

Table A- 7. Basic assumptions from the Commission's 2003 autumn forecast

	2003	2004	2005	2006	2007	2008
Basic assumptions						
Short-term interest rate (annual average)	2.3	2.1	2.6	3.2	3.0	3.0
Long-term interest rate (annual average)	4.2	4.2	4.6	4.8	4.9	4.9
USD/€ exchange rate (annual average)	0.89	0.81	0.80	0.78	0.75	0.75
(for non-euro countries) exchange rate vis-à-vis the € (annual average)	4.2	5.7	4.8	4.6	5.0	5.0
World excluding EU.GDP growth	0.8	2.5	2.3	2.4	2.2	2.4
EU-15 GDP growth	-	9.0	7.9	7.3	7.0	8.0
Growth of relevant foreign markets	10.3	11.6	8.8	8.3	8.0	9.0
World import volumes. excluding EU	32.2	39.3	35	35	35	35
Oil prices	2.3	2.1	2.6	3.2	3.0	3.0

Annex 2: Indicators of long-term sustainability

Table A- 8: Long-term sustainability of public finances in Austria – quantitative scenarios

Main assumptions - baseline scenario (as % GDP)	2009	2010	2020	2030	2040	2050	changes
Total age-related spending	26,5	26,4	27,0	27,6	27,7	27,0	0,5
Pensions	14,2	14,2	14,6	14,9	14,5	13,6	-0,6
Health care	5,2	5,3	5,6	6,0	6,3	6,4	1,2
Care of the elderly	0,8	0,8	1,0	1,1	1,3	1,5	0,7
Education*	5,6	5,5	5,3	5,1	5,1	5,0	-0,6
Unemployment benefits*	0,7	0,7	0,5	0,5	0,6	0,5	-0,2
Others	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Total primary non age-related spending**	16,4						
Total revenues**	45,8						

* EPC projections

** constant

Results (as % GDP)	2009	2010	2020	2030	2040	2050	changes
Baseline scenario							
Gross debt	59,1	54,2	33,0	16,4	2,6	-18,6	-77,7
i + 0.5*	59,1	54,7	36,1	21,4	9,4	-10,3	-69,4
2004 scenario							
Gross debt	59,6	55,3	37,6	24,9	15,9	0,6	-59,0
i + 0.5*	59,6	55,9	40,8	30,4	23,9	11,2	-48,4

* i + 0.5 represents the evolution of debt under the assumption of the nominal interest rate being 50 basis points higher throughout the projection period.

