COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.1.2005
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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Austria, 2004-2008

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1] stipulates that participating Member States, that is, those which have adopted the single currency, had to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their stability programmes, which may also be examined by the Council in accordance with these same procedures.

The first stability programme of Austria, covering the period 1998-2002 was submitted on 30 November 1998 and assessed by the Council on 18 January 1999. Updates were presented every following year. Austria submitted the most recent update of its stability programme on 30 November 2004. The Commission services have carried out a technical evaluation of this update, taking into account the results of the Commission services Autumn 2004 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies[3]. This evaluation warrants the following assessment:

– 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 largely complies with the revised "Code of Conduct on the content and format of stability and convergence programmes", except for a small number of minor deviations in the ESA reporting format. 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

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1 OJ L 209, 2.8.1997. All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

2 Revised Opinion of the Economic and Financial Committee on the content and format of stability and converge programmes, endorsed by the Ecofin Council on 10.7.2001.

3 COM(2002) 668 final, 27.11.2002.

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 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	1.9	2.4	2.4	n.a.	n.a.
	SP Nov 2003	*1.9*	*2.5*	*2.5*	*2.4*	*n.a.*
HICP inflation (%)	**SP Dec 2004**	**2.1**	**1.8**	**1.4**	**1.5**	**1.6**
	COM	2.1	1.8	1.4	n.a.	n.a.
	SP Nov 2003	*1.2*	*1.5*	*1.7*	*1.8*	*n.a.*
General government balance (% of GDP)	**SP Dec 2004**	**-1.3**	**-1.9**	**-1.7**	**-0.8**	**0.0**
	COM	-1.3	-2.0	-1.7	n.a.	n.a.
	SP Nov 2003	*-0.7*	*-1.5*	*-1.1*	*-0.4*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2004**	**1.9**	**1.2**	**1.3**	**2.2**	**2.9**
	COM	1.7	0.9	1.2	n.a.	n.a.
	SP Nov 2003	*2.8*	*1.9*	*2.2*	*2.8*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Dec 2004**[1]	**-0.9**	**-1.7**	**-1.6**	**-0.8**	**-0.1**
	COM	-1.0	-1.9	-1.7	n.a.	n.a.
	SP Nov 2003[1]	-0.4	-1.4	-1.1	-0.5	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2004**	**64.2**	**63.6**	**63.1**	**61.6**	**59.1**
	COM	64.0	63.9	63.4	n.a.	n.a.
	SP Nov 2003	*65.8*	*64.1*	*62.3*	*59.9*	*n.a.*

[1]Commission services' calculations on the basis of the information in the programme
Sources:
Stability programme (SP); Commission services' autumn 2004 economic forecasts (COM); Commission services' calculations.

Based on this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the updated stability programme of Austria and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Austria, 2004-2008

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council regulation (EC) No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[4], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [18 January 2005] the Council examined the updated stability programme of Austria, which covers the period 2004-2008. The programme largely complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes", except for a small number of minor deviations in the ESA reporting format.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will pick up from 1.9% in 2004 and remain at around 2½% over the remainder of the programme period. On the basis of the currently available information this scenario seems to reflect plausible growth assumptions for the first years, but appears rather too favourable for the final years, as the forecast remains above potential output for four years in a row. The programme's projections for inflation are realistic.

(3) Austria aims to achieve a balanced budget by 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 a 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. The

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4 OJ L 209, 2.8.1997. All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

consolidation path 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.

(4) The budgetary outcome could be worse than projected in the programme. In particular, the budgetary path front-loads tax relief but back-loads the corresponding restraint on expenditure. Risks are balanced for 2005 and 2006, when deficit developments are dominated by the sizeable tax cuts that will become effective on 1 January 2005, and in view of a realistic underlying macroeconomic scenario. However, for the outer years 2007/08, risks appear to be downward-biased as, first, GDP growth is assumed to remain above potential and, second, the envisaged substantial fall in the expenditure/GDP ratio remains largely unspecified in the programme. In view of this risk assessment, the budgetary stance in the programme may not be sufficient to achieve the Stability and Growth Pact's medium-term objective of a budgetary position of close-to-balance in cyclically-adjusted terms by 2008. 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.

(5) The debt ratio is estimated to have reached 64.2% of GDP in 2004, above the 60%-of-GDP Treaty reference value. The programme projects the debt ratio to decline by 5 percentage points over the programme period. The evolution of the debt ratio may be less favourable than projected given the risks to the budgetary targets mentioned above. On the other hand, Austria could potentially compensate for this risk with large-scale privatisations.

(6) 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, the savings in earlier periods introduced by the 2003 reform step have been taken back to some extent.

(7) 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 close to balance is projected to be reached only in the final year of the programme.

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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.

Key projections from the updated stability programme of Austria

	2003	2004	2005	2006	2007	2008
Real GDP growth (%)	0.8	1.9	2.5	2.5	2.2	2.4
HICP inflation (%)	1.3	2.1	1.8	1.4	1.5	1.6
General government balance (% of GDP)	-1.1	-1.3	-1.9	-1.7	-0.8	0.0
Primary balance (% of GDP)	2.1	1.9	1.2	1.3	2.2	2.9
Cyclically-adjusted balance (% of GDP)[1]	-0.7	-0.9	-1.7	-1.6	-0.8	-0.1
Government gross debt (% of GDP)	64.5	64.2	63.6	63.1	61.6	59.1

[1] Commission services' calculations applying the commonly agreed methodology to the information in the programme.