COMMISSION OF THE EUROPEAN COMMUNITIES

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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, 2005-2008

(presented by the Commission)

EXPLANATORY MEMORANDUM

Background

The Stability and Growth Pact, which entered into force on 1 July 1998, is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. In 2005, the Pact was amended for the first time. The reform acknowledged the Pact's usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Pact, stipulates that Member States have to submit, to the Council and the Commission, stability or convergence programmes and annual updates thereof (Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes). The first stability programme of Austria was submitted in November 1998. In accordance with the Regulation, the Council delivered an opinion on it on 18 January 1999 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. In accordance with the same procedure, updated stability and convergence programmes are assessed by the Commission and examined by the Committee mentioned above, while the Council may examine them.

In these programmes, Member States need to specify their medium-term objective for the budgetary position and set out the policy measures to achieve and maintain it, including the accompanying economic assumptions. Following the reform of the Pact, the medium-term objective should be differentiated for individual Member States in the light of the economic and budgetary heterogeneity in the Union, including as regards the fiscal risk to sustainability. Other elements of the reform are that a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in economic good times should be achieved, while "major structural reforms" with a verifiable impact on long-term sustainability should be taken into account for a temporary deviation from the medium-term objective or the adjustment path towards it.

Taking into account the Commission services' autumn 2005 forecast, the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances and the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008, the Commission has examined the recently submitted update of the stability programme of Austria and, based on its assessment below, has adopted a recommendation for a Council opinion on it.

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1 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). 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 "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005.

Assessment

(1) On 30 November 2005 Austria submitted its most recent update of the stability programme, which covers the period from 2005 to 2008. The programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct[3].

(2) In its opinion of 18 January 2005 on the previous update of the stability programme, covering the period 2004-2008, the Council invited Austria to achieve a higher degree of front-loading in the overall budget consolidation path and to 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.

(3) In the last decade, the Austrian economy grew on average by 2.2% per year in real terms, matching the growth rate for the euro zone as a whole. While job creation has been less dynamic than in the euro area, Austria still enjoys one of the lowest unemployment rates in the whole EU. In budgetary terms, the country achieved a "surplus or close-to-balance position" of public finance in 2001 and 2002. However, recent developments have been characterised by a relapse into deficit (1.2% and 1% of GDP in 2003 and 2004 respectively).

(4) According to the update, real GDP growth is expected to pick up from annual rates of 1¾% in 2005 and 2006 to 2½% in 2008. Slower than previously assumed growth in 2005 and 2006, resulting in a widening of the negative output gap, is attributed to less buoyant international trade and higher oil prices. The pick up of economic activity in the outer years of the programme is expected on the back of growing investment and private consumption. Both the short-term and medium-term scenario is based on plausible growth assumptions. However, expectation of employment gains would appear somewhat optimistic. Inflation is expected to decline from 2.3% in 2005 to 1.5% in 2008, which seems plausible.

(5) According to preliminary results, in 2005 the general government deficit amounted to 1.7% of GDP, which was 0.2 and 0.1 percentage point lower than planned in the updated programme and than forecasted by the Commission services respectively. The better-than-planned result was due to more favourable-than-foreseen developments on the revenue side in spite of substantial tax cuts. The planned expenditure was also exceeded, however, by a smaller margin.

(6) The programme describes the budgetary strategy as "three-pronged". First, it aims at a balanced budget over the economic cycle. Second, the strategy foresees a decline in the tax burden to 40% of GDP by 2010. Third, it envisages raising potential growth by fostering investment in research, education and infrastructure. The update foresees a decline in the general government deficit from 1.9% of GDP in 2005 to 0% in 2008. The fiscal adjustment towards a balanced budget is back-loaded, with only a minor improvement in 2006, followed by two relatively more substantial steps. The profile of the primary surplus is similar. It is expected to rise from 1.1% of GDP in 2005 to 2.7% at the end of the period. Since revenue is expected to fall by 0.9 percentage point of

[3] It provides all compulsory and most optional data prescribed by the latter. A minor gap is the missing calculation of tax burden in Table 2.

GDP over the period 2005-2008, the planned consolidation is planned to be achieved via expenditure cuts, with the expenditure-to-GDP ratio dropping by 2.8 percentage points. The bulk of the retrenchment on the expenditure side is projected to fall on the categories “other primary expenditure” and “social transfers”. Compared with the previous programme, the new update broadly confirms the planned adjustment against however a less favourable macroeconomic scenario.

(7) The structural balance (in cyclically-adjusted terms and net of one-off and other temporary measures) is planned to improve on average by around 0.5 percentage point of GDP per year against the background of negative output gap throughout the period. The programme sets the medium-term objective (MTO) for the budgetary position as meant in the Stability and Growth Pact at 0% of GDP in structural terms and aims at achieving this position by 2008. As the programme’s MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1½% of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. As regards appropriateness, the programme’s MTO lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is more demanding than implied by the debt ratio and average potential output growth in the long term.

(8) The budgetary path projected in the update seems plausible for the years 2005 and 2006, when it is based on legislated measures, notably the tax cuts. The consolidation in 2007 and 2008 does not seem fully substantiated by the policy measures discussed in the update. Moreover, the credibility of the projected improvement relies largely on the effectiveness of the Austrian National Stability Pact. Previous experience with the pact offers only limited help in determining whether its targets will be respected. The implementation of envisaged expenditure targets remains the main risk to the budgetary strategy, as has been stressed already in the assessments of previous updates.

(9) In view of this risk assessment, the budgetary stance in the programme may not be sufficient to ensure that the programme’s MTO is achieved by 2008. However, as stated above, the programme’s MTO is more demanding than required by the Stability and Growth Pact. The budgetary strategy, if implemented as specified in the programme, seems adequate to achieve a budgetary position in structural terms that can be considered as appropriate under the Pact by the end of the programme period. In addition, the budgetary stance in the programme seems to provide a sufficient safety margin against breaching the 3% of GDP deficit ceiling with normal cyclical fluctuations throughout the programme period. The pace of the adjustment towards the programme’s MTO implied by the programme is fully in line with the Stability and Growth Pact, which specifies that, for euro area and ERM II Member States, the annual improvement in the structural balance should be 0.5% of GDP as a benchmark and that the adjustment should be higher in good economic times and could be lower in bad economic times. While the Commission services are expecting this adjustment to be slower than foreseen in the programme, it would still be compatible with the requirements of the Pact, given the existence of a negative output gap throughout the programme period.

(10) The debt ratio is estimated to have reached 63.4% of GDP in 2005, thus slightly above the 60% of GDP Treaty reference value. The programme projects a decline in the debt ratio of 3.9 percentage points over the programme period, thereby returning below the

reference value. The contribution from the primary balance is set to increase substantially over the programme period, while those from interest payments and nominal GDP growth are expected to remain largely unchanged. The risks to the projected evolution of the debt ratio appear to be broadly balanced. On the one hand, higher-than-targeted deficits could endanger adherence to the adjustment path presented in the programme. On the other hand, the update does not include the potential of privatisation in Austria. In view of this risk assessment, the debt ratio seems to be sufficiently diminishing towards the reference value.

(11) With regard to the sustainability of public finances, Austria appears to be at low risk on grounds of the projected budgetary costs of ageing populations. The level of debt, currently above 60% of GDP, is projected to fall and remain below the reference value up to 2050 on the assumption that the planned budgetary consolidation is implemented. Austria's recent pension reform should contribute significantly to the containment of future increases in public expenditure. However, the structural deficit in the government finances, if not corrected, could pose a risk to public finance sustainability. Implementing the planned consolidation of public finances over the medium-term is therefore instrumental for reducing the risks to public finance sustainability.

(12) The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008. In particular, the measures are in line with the guidelines recommending safeguarding economic and fiscal sustainability and promoting an efficient allocation of resources geared towards higher growth and employment. However, the downside risks to the future budgetary developments could make the achievement of the country's medium-term objective more difficult to obtain.

(13) The National Reform Programme of Austria, submitted on 19 October 2005 in the context of the renewed Lisbon strategy for growth and jobs, identifies the achievement of sustainable public finances as one of the key challenges for Austria. However, it does not spell out future measures envisaged towards meeting this challenge. In that respect, the stability programme is more detailed, providing information on some of the measures that are to contribute to the consolidation of public finances. The budgetary implications of the actions in the microeconomic and employment areas outlined in the National Reform Programme are broadly reflected in the budgetary projections of the stability programme. The latter outlines measures aimed at making the public administration and the health care system more efficient. It complements these with proposals for changes in the institutional features of the public finances, namely two comprehensive reforms of the legislation governing the budgetary process in Austria, which consist in the introduction of the medium-term budgetary framework from 2007 and shifting from input-dominated to objective-driven budgets from 2011. These measures are in line with the priorities laid out in the National Reform Programme.

In view of the above assessment, the ambitious structural adjustment planned over the programme period can be welcomed. However, Austria should make sure that the programme's MTO is achieved by the end of the update period by further specifying and implementing measures that will support the budgetary consolidation planned for the two final years of the programme.

Recommendation for a

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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, 2005-2008

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) In the last decade, the Austrian economy grew on average by 2.2% per year in real terms, matching the growth rate for the euro zone as a whole. While job creation has been less dynamic than in the euro area, Austria still enjoys one of the lowest unemployment rates in the whole EU. In budgetary terms, the country achieved a "surplus or close-to-balance position" of public finance in 2001 and 2002. However, recent developments have been characterised by a relapse into deficit (1.2% and 1% of GDP in 2003 and 2004 respectively).

(2) In its opinion of 18 January 2005 on the previous update of the stability programme, covering the period 2004-2008, the Council invited Austria to achieve a higher degree of front-loading in the overall budget consolidation path and to 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.

(3) According to preliminary results, in 2005 the general government deficit amounted to 1.7% of GDP, which was 0.2 and 0.1 percentage point lower than planned in the updated programme and than forecasted by the Commission services respectively. The better-than-planned result was due to more favourable-than-foreseen developments on

[4] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). 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

the revenue side in spite of substantial tax cuts. The planned expenditure was also exceeded, however, by a smaller margin.

(4) On [14 February 2006] the Council examined the updated stability programme of Austria, which covers the period 2005 to 2008. The programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct[5].

(5) According to the update, real GDP growth is expected to pick up from annual rates of 1¾% in 2005 and 2006 to 2½% in 2008. Slower than previously assumed growth in 2005 and 2006, resulting in a widening of the negative output gap, is attributed to less buoyant international trade and higher oil prices. The pick up of economic activity in the outer years of the programme is expected on the back of growing investment and private consumption. Both the short-term and medium-term scenario is based on plausible growth assumptions. However, expectation of employment gains would appear somewhat optimistic. Inflation is expected to decline from 2.3% in 2005 to 1.5% in 2008, which seems plausible.

(6) The programme describes the budgetary strategy as "three-pronged". First, it aims at a balanced budget over the economic cycle. Second, the strategy foresees a decline in the tax burden to 40% of GDP by 2010. Third, it envisages raising potential growth by fostering investment in research, education and infrastructure. The update targets a decline in the general government deficit from 1.9% of GDP in 2005 to 0% in 2008 and an increase in the primary surplus from 1.1% of GDP to 2.7%. Since revenue is expected to fall by 0.9 percentage point of GDP over the period 2005-2008, the planned consolidation is going to rely on expenditure restraint, with the expenditure-to-GDP-ratio dropping by 2.8 percentage points. The bulk of the retrenchment on the expenditure side is to fall on the categories "other primary expenditure" and "social transfers". Compared with the previous programme, the new update broadly confirms the planned adjustment against a less favourable macroeconomic scenario.

(7) Over the programme period, the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology based on the programme data is planned to improve on average by about 0.5% of GDP per year. The programme sets the medium-term objective (MTO) for the budgetary position at 0% of GDP in structural terms and aims at achieving this position by 2008. As regards appropriateness, the programme's MTO lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is more demanding than implied by the debt ratio and average potential output growth in the long term.

(8) The budgetary path projected for 2005 and 2006 seems broadly plausible as it is based on legislated measures, notably the tax cuts. However, the consolidation in 2007 and 2008 does not seem fully substantiated by the policy measures discussed in the update. Almost half of the expenditure restraint effort falls into the category "other primary expenditure" and no information is provided in the programme on how exactly this is going to be done. On top of that, the credibility of the projected improvement relies

[5] It provides all compulsory and most optional data prescribed by the latter. A minor gap is the missing calculation of tax burden in Table 2.

largely on the effectiveness of the Austrian National Stability Pact. However, previous experience with the pact offers only limited help in determining whether its targets will be respected.

(9) In view of this risk assessment, the budgetary stance in the programme may not be sufficient to ensure that the programme's MTO is achieved by 2008. However, as stated above, the programme's MTO is more demanding than required by the Stability and Growth Pact. The budgetary strategy, on the condition that it is implemented as presented in the programme, seems adequate to achieve a budgetary position in structural terms that can be considered as appropriate under the Pact by the end of the programme period. In addition, the budgetary stance in the programme seems to provide a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period. The pace of the adjustment towards the programme's MTO implied by the programme is fully in line with the Stability and Growth Pact, which specifies that, for euro area and ERM II Member States, the annual improvement in the structural balance should be 0.5% of GDP as a benchmark and that the adjustment should be higher in good economic times and could be lower in bad economic times. While according to the Commission services this adjustment is going to be slower on annual average than foreseen in the programme, it would still be compatible with the requirements of the Pact, especially in the face of a negative output gap throughout the programme period.

(10) The debt ratio is estimated to have reached 63.4% of GDP in 2005, thus slightly above the 60% of GDP Treaty reference value. The programme projects the debt ratio to decline by 3.9 percentage points over the programme period, thereby returning below the reference value. The risks to the projected evolution of the debt ratio appear to be broadly balanced. On the one hand, higher-than-targeted deficits could endanger adherence to the adjustment path presented in the programme. On the other hand, the update does not include potential privatisation receipts. In view of this risk assessment, the debt ratio seems to be sufficiently diminishing towards the reference value.

(11) With regard to the sustainability of public finances, Austria appears to be at low risk on grounds of the projected budgetary costs of ageing populations[6]. The level of debt, currently above 60% of GDP, is projected to fall and remain below the reference value up to 2050 on the assumption that the planned budgetary consolidation is implemented. Austria's recent pension reform should contribute significantly to the containment of future increases in public expenditure. However, the structural deficit in the government finances, if not corrected, could pose a risk to public finance sustainability. Implementing the planned consolidation of public finances over the medium-term is therefore instrumental for reducing the risks to public finance sustainability.

(12) The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines for the period 2005-2008. In particular, the measures are in line with the guidelines recommending safeguarding economic and fiscal sustainability and promoting an efficient allocation of resources geared towards higher growth and employment. However, the downside risks to the future budgetary

[6] Details on long-term sustainability are provided in the technical assessment of the programme by the Commission services (http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

developments could make the achievement of the country's medium-term objective more difficult to obtain.

(13) The National Reform Programme of Austria, submitted on 19 October 2005, identifies the achievement of sustainable public finances as one of the key challenges for Austria. However, it does not spell out any future measures envisaged towards meeting this challenge. In that respect, the stability programme is more detailed, providing information on some of the measures that are to contribute to the consolidation of public finances. The budgetary implications of the actions in the microeconomic and employment areas outlined in the National Reform Programme are broadly reflected in the budgetary projections of the stability programme. The latter outlines measures aimed at making the public administration and the health care system more efficient. It complements these with proposals for changes in the institutional features of the public finances, namely two comprehensive reforms of the legislation governing the budgetary process in Austria, which consist in the introduction of the medium-term budgetary framework from 2007 and shifting from input-dominated to objective-driven budgets from 2011. These measures are in line with the priorities laid out in the National Reform Programme.

In view of the above assessment, the Council welcomes the ambitious structural adjustment planned over the programme period. However, the Council considers that Austria should make sure that the programme's MTO is achieved by the end of the update period by further specifying and implementing the necessary measures that will support the budgetary consolidation planned for the two final years of the programme.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	**SP Nov 2005**	**2.4**	**1.7**	**1.8**	**2.4**	**2.5**
	COM Nov 2005	2.4	1.7	1.9	2.2	n.a.
	SP Nov 2004	*1.9*	*2.5*	*2.5*	*2.2*	*2.4*
HICP inflation (%)	**SP Nov 2005**	**2.0**	**2.3**	**2.1**	**1.7**	**1.5**
	COM Nov 2005	2.0	2.2	2.1	1.7	n.a.
	SP Nov 2004	*2.1*	*1.8*	*1.4*	*1.5*	*1.6*
Output gap (% of potential GDP)	**SP Nov 2005**[1]	**-0.2**	**-0.7**	**-1.1**	**-0.9**	**-0.5**
	COM Nov 2005[3]	-0.2	-0.7	-1.0	-0.9	n.a.
	SP Nov 2004[1]	*-1.3*	*-0.8*	*-0.4*	*-0.1*	*0.2*
General government balance (% of GDP)	**SP Nov 2005**	**-1.0**	**-1.9**	**-1.7**	**-0.8**	**0.0**
	COM Nov 2005[2]	-1.0	-1.8	-1.8	-1.4	n.a.
	SP Nov 2004	*-1.3*	*-1.9*	*-1.7*	*-0.8*	*0.0*
Primary balance (% of GDP)	**SP Nov 2005**	**2.1**	**1.1**	**1.2**	**2.0**	**2.7**
	COM Nov 2005	1.9	1.0	1.0	1.4	n.a.
	SP Nov 2004	*1.9*	*1.2*	*1.3*	*2.2*	*2.9*
Cyclically-adjusted balance = structural balance (% of GDP)	**SP Nov 2005**[1]	**-0.9**	**-1.6**	**-1.2**	**-0.4**	**0.2**
	COM Nov 2005	-0.9	-1.5	-1.3	-1.0	n.a.
	SP Nov 2004[1]	*-0.9*	*-1.7*	*-1.6*	*-0.8*	*-0.1*
Government gross debt (% of GDP)	**SP Nov 2005**	**63.6**	**63.4**	**63.1**	**61.6**	**59.5**
	COM Nov 2005[2]	63.7	63.6	63.5	62.8	n.a.
	SP Nov 2004	*64.2*	*63.6*	*63.1*	*61.6*	*59.1*

Notes:
[1] Commission services calculations on the basis of the information in the programme.
[2] Commission services' autumn 2005 forecast projections for the deficit and debt ratios have been adjusted to be comparable with the projections in the stability programme by recalculating the ratios on the basis of the new GDP series.
[3] Based on estimated potential growth of 1.9%, 2.2%, 2.2% and 2.1% respectively in the period 2004-2007.

Source:
Stability programme (SP); Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations.