# ECONOMIC ASSESSMENT

# OF THE STABILITY PROGRAMME OF AUSTRIA

# (UPDATE OF MARCH 2007)

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The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not. The most recent update of Austria's stability programme was submitted on 29 March 2007.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs of the European Commission, was finalised on 21 May 2007. Comments should be sent to Georg Busch (georg.busch@ec.europa.eu). The main aim of the technical analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 30 May 2007. The ECOFIN Council is expected to adopt its opinion on the programme on 9 July 2007.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

**http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm**

**Table of contents**

As part of the preventive arm of the Stability and Growth Pact, each Member State that uses the single currency, such as Austria, has to submit a stability programme and annual updates thereof. The most recent programme, covering the period 2006-2010, was submitted on 29 March 2007, following the presentation of the twin budget for 2007/2008 to Parliament by the new government on the same day, but two and a half months after the 15 December deadline for Austria foreseen in the code of conduct.

In the last decade, Austrian economic performance was characterised by steady growth slightly above the euro area average and the absence of major distortions. Real GDP growth, largely driven by exports, slowed down substantially in the period 2001-2003, as a reflection of the global and in particular euro-area economic weakening. Thanks to its geographical position, Austria was able to reap substantial benefits from increasing ties with Central and Eastern Europe. It enjoyed one of the lowest unemployment and inflation rates in the euro-area and managed to lower its unit labour costs faster than the euro-area members on average, which greatly enhanced the country's competitive position. Austria reduced the high general government budget deficit from the mid-1990s, leading to a balanced position in 2001 but relapsing into a small deficit in the years thereafter. Significant reforms in public administration, pension and health care have been implemented.

However, the employment rate of workers aged 55 and above is the third lowest in the EU. Despite past initiatives, incentives remain for early retirement. Moreover, the harmonisation of pension schemes for public sector employees with that for the private sector needs to be completed. Also, Austria considers to introduce a medium-term budgetary planning framework for the federal government, which still awaits legislation.

The macroeconomic scenario underlying the updated stability programme envisages that real GDP growth will decelerate from a cyclical peak of 3.1 % in 2006 to 2½ % on average over the rest of the programme period. Assessed against currently available information, this scenario appears to be based on somewhat cautious growth assumptions until 2008, as recent data point to somewhat more robust growth. For the outer years of the programme period, the projection seems plausible, even if the growth rates are slightly higher than the average potential growth rate calculated by the Commission services. The programme's projections for inflation appear realistic. At present, Austria is experiencing a period of economic good times, as the output gap has narrowed and almost closed in 2006.

For 2006, the general government deficit amounted to 1.1 % of GDP, against a target of 1.7 % of GDP set in the previous update of the stability programme. This improvement over the target results from the better-than-expected cyclical developments. Although the revenue-to-GDP ratio fell slightly compared with the previous year, it turned out higher by more than one percentage point over the target. Higher-than-expected GDP growth contributed to the decline in the expenditure ratio compared with the previous year.

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[1]The analysis takes into account (i) the Commission services' spring 2007 forecast, (ii) the code of conduct ("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) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

However, the expenditure ratio increased by more than ½ percentage point over the target, indicating that budgetary execution was not as tight as planned.

The main goal of the budgetary strategy is to reach a balanced budget over the cycle, reaping the benefits of administrative reform while reinforcing expenditure in several categories. In comparison with the previous update, the latter is reflected in the postponement of the budgetary consolidation to the outer years of the programme period. The update projects the general government position to improve from a deficit of 1.1 % of GDP in 2006 to a surplus of 0.4 % in 2010. The consolidation, which is back-loaded to the last two years of the programme period, is planned to be expenditure-based, with restraint in social spending and the gradual phasing-out of some specific expenditure being the main factors. Compared with the previous programme, the new update backloads the planned adjustment against a broadly more favourable macroeconomic scenario. Government gross debt is estimated to have declined to 62.2 % of GDP in 2006, projected to fall below the 60%-of-GDP reference value by 2008 and to decline further to 56.8 % of GDP by 2010.

The structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology improves very gradually from a deficit of around 1 % of GDP in 2006 and swings to a slight surplus by 2010. According to the programme, the profile of the adjustment is affected by the purchase of military equipment between 2007 and 2009, which, unlike the Commission services' spring forecast, it considers being a deficit-increasing one-off measure. As in the previous update of the stability programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a balanced position in structural terms, which is in line with the Pact. However, the programme aims to nearly reach the MTO by 2009 and to surpass it slightly in 2010, rather than to achieve it already in 2008 as in the previous update.

The risks to the budgetary projections in the programme appear broadly balanced for 2007 and 2008, but for 2009 and 2010, the budgetary outcomes could be worse than projected, despite plausible macroeconomic assumptions. Indeed, the expenditure-to-GDP ratio is foreseen to fall significantly in the two final years. The phasing out of specific expenditures, in particular on military equipment, and the expenditure savings on unemployment benefits and on pensions, as a result of the 2004 pension reform, should contribute to the decline in the expenditure ratio in the outer years. On the other hand, additional spending would be made over the programme period, while the expected efficiency gains in public administration remain uncertain. Finally, the programme hints at the possibility of further tax cuts financed by the planned expenditure savings.

In view of the risk assessment, the budgetary stance in the programme may not be sufficient to ensure that the MTO is achieved by 2010, as envisaged in the programme. The Commission services' spring forecast estimates the structural deficit to widen in 2007 and 2008. However, a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations is maintained throughout the programme period. The pace of the adjustment towards the MTO implied by the programme is insufficient and should be strengthened, especially in 2007 and 2008, to be in line with the Stability and Growth Pact. In particular, only a limited improvement in the structural balance is planned between 2007 and 2009, when Austria is expected to experience good times. This conclusion is confirmed even if one considers the purchase of military equipment to constitute a deficit-increasing one-off measure, as the programme does. The debt ratio seems to be sufficiently diminishing towards the

reference value in the early part of the programme period and is planned to approach it by 2007.

The long-term budgetary impact of ageing in Austria is well below the EU average, with pension expenditure projected to decrease as a share of GDP over the long-term, as a consequence of the significant expenditure containment expected from the 2004 pension reform. Overall, Austria appears to be at low risk with regard to the sustainability of public finances.

The stability programme contains a qualitative assessment of the overall impact of the September 2006 implementation report of the National Reform Programme within the medium-term fiscal strategy. In addition, it provides some information on the direct budgetary costs or savings of the main reforms envisaged in the National Reform Programme and the public finance implications of the actions outlined in the National Reform Programme are broadly consistent with its budgetary projections.. The measures in the area of public finances envisaged in the stability programme seem consistent with those foreseen in the National Reform Programme. In particular, expected savings from administrative reform and the reinforcement of spending on R&D are put forward in both programmes.

The overall conclusion is that, in a context of robust growth prospects, the programme envisages slow progress towards the MTO through a relatively back-loaded adjustment that is based mainly on not-fully-specified expenditure restraint. There are risks to the achievement of the budgetary targets after 2008 and the MTO might not be reached by the end of the programme period. Government debt would approach the 60 % of GDP reference value in 2007 and continue to decline in subsequent years.

# Comparison of key macroeconomic and budgetary projections

|  |  | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| Real GDP (% change) | **SP Mar. 2007** | **2.0** | **3.1** | **2.7** | **2.3** | **2.5** | **2.6** |
|  | COM May 2007 | 2.0 | 3.1 | 2.9 | 2.5 | n.a. | n.a. |
|  | *SP Nov. 2005* | *1.7* | *1.8* | *2.4* | *2.5* | *n.a.* | *n.a.* |
| HICP inflation (%) | **SP Mar. 2007** | **2.1** | **1.5** | **1.6** | **1.7** | **1.7** | **1.8** |
|  | COM May 2007 | 2.1 | 1.7 | 1.8 | 1.7 | n.a. | n.a. |
|  | *SP Nov. 2005* | *2.3* | *2.1* | *1.7* | *1.5* | *n.a.* | *n.a.* |
| Output gap (% of potential GDP) | **SP Mar. 2007[1]** | **-1.1** | **-0.3** | **0.1** | **-0.1** | **0.1** | **0.3** |
|  | COM May 2007[5] | -1.1 | -0.2 | 0.5 | 0.8 | n.a. | n.a. |
|  | *SP Nov. 2005[1]* | *-0.7* | *-1.1* | *-0.9* | *-0.5* | *n.a.* | *n.a.* |
| General government balance (% of GDP) | **SP Mar. 2007** | **-1.6** | **-1.1** | **-0.9** | **-0.7** | **-0.2** | **0.4** |
|  | COM May 2007 | -1.6 | -1.1 | -0.9 | -0.8 | n.a. | n.a. |
|  | *SP Nov. 2005* | *-1.9* | *-1.7* | *-0.8* | *0.0* | *n.a.* | *n.a.* |
| Primary balance[6] (% of GDP) | **SP Mar. 2007** | **1.3** | **1.9** | **2.0** | **2.1** | **2.6** | **3.1** |
|  | COM May 2007 | 1.3 | 1.6 | 1.8 | 1.7 | n.a. | **n.a.** |
|  | *SP Nov. 2005* | *1.1* | *1.2* | *2.0* | *2.7* | *n.a.* | *n.a.* |
| Cyclically-adjusted balance (% of GDP) | **SP Mar. 2007[1]** | **-1.1** | **-1.0** | **-0.9** | **-0.7** | **-0.2** | **0.2** |
|  | COM May 2007 | -1.1 | -1.0 | -1.1 | -1.2 | n.a. | n.a. |
|  | *SP Nov. 2005* | *-1.6* | *-1.2* | *-0.4* | *0.2* | *n.a.* | *n.a.* |
| Structural balance[2] (% of GDP) | **SP Mar. 2007[3]** | **-1.1** | **-1.0** | **-0.8** | **-0.4** | **-0.2** | **0.2** |
|  | COM May 2007[4] | -1.1 | -1.0 | -1.1 | -1.2 | n.a. | n.a. |
|  | *SP Nov. 2005* | *-1.6* | *-1.2* | *-0.4* | *0.2* | *n.a.* | *n.a.* |
| Government gross debt (% of GDP) | **SP Mar. 2007** | **63.5** | **62.2** | **61.2** | **59.9** | **58.5** | **56.8** |
|  | COM May 2007 | 63.5 | 62.2 | 60.6 | 59.2 | n.a. | n.a. |
|  | *SP Nov. 2005* | *63.4* | *63.1* | *61.6* | *59.5* | *n.a.* | *n.a.* |

Notes:

[1]Commission services calculations on the basis of the information in the programme with potential growth estimated at 2.3%, 2.3%, 2.4%, 2.4% and 2.3% respectively in the period 2006-2010.

[2]Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures

[3]Deficit-increasing one-off and other temporary measures taken from the programme (0.2% of GDP in 2007, 0.4% in 2008 and 0.1% in 2009).

[4]As compared to the programme (see note 3) the Commission services' spring 2007 forecast did not treat any military expenditures as one-offs.

[5]Based on estimated potential growth of 2.3%, 2.0%, 2.2% and 2.2% respectively in the period 2005-2008.

[6] Data on the primary balance in the programme and in the Commission services' forecasts are not directly comparable because of a different treatment of FISIM. Data in the programme follow the definitions required by the code of conduct. To be comparable with data in the programme, Commission data on the primary balance need to be adjusted by around 0.1-0.2% of GDP.

*Source:*

*Stability programme (SP); Commission services' spring 2007 economic forecasts (COM); Commission services' calculations*

# 1. INTRODUCTION

The most recent update of the Austrian stability programme was adopted by the Austrian Council of Ministers and submitted to the European Commission on 29 March 2007. The English version of the update was delivered on 30 March 2007. The programme was adopted jointly with the presentation of the twin budget 2007/2008 by the Minister of Finance. The budget was adopted by the Parliament on 3 May 2007. The late delivery of the programme compared with the 15 December deadline in the code of conduct results from the dates of the federal election in October 2006 and the formation of the Government in 9 January 2007.

The update covers the period from 2006 to 2010. It broadly follows the model structure for stability and convergence programmes specified in the code of conduct. It provides all compulsory and  presents some gaps in the optional data prescribed by the  code of conduct.[2] Annex 3 provides a detailed overview of all aspects of compliance with the code of conduct.

Some of the programme's budgetary projections were revised by the Ministry of Finance after the submission of the programme. The revision, which was submitted to the Commission on 25 April 2007 (i.e. one month after the programme update), is taken into account in this assessment.

# 2. ECONOMIC TRENDS AND POLICY CHALLENGES

This section is in five parts. The first provides a brief overview of the macroeconomic performance in terms of growth and other macro-variables. The second part presents the results of a growth accounting exercise and tries to identify the main reasons for low or high average annual growth vis-à-vis the reference aggregate (euro area and EU25). The third looks at the volatility of growth and other key macroeconomic variables and the stabilising or destabilising role of macro-policies. The fourth part focuses on trends in public finances. The fifth part then identifies major economic challenges with implications for public finances.

## 2.1. Economic performance

In the course of the ten year period from 1996 to 2005, Austrian real GDP growth amounted on average to 2.2% per year, slightly above that of the euro area as a whole (See Figure 1). In the first half of the decade average real GDP growth amounted to 2.9% and was mainly driven by domestic demand. The latter's contribution to growth was almost four times higher than that of the net exports. Economic growth peaked in the years 1998-2000 around 3.5%, only to see a substantial decline in the following three years, which reflected a significant slowdown of economic activity in Germany, Italy and Switzerland – Austria's main trading partners.

Due to the 2001-2003 slowdown, the average Austrian growth rate of GDP went down to 1.5% in the second half of the decade. In that period growth became much more broad-based as domestic demand and net exports provided almost equal contributions to it.

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[2] Optional data on employment and hours worked as well as public sector wages are not provided.

As can be seen from Figure 2, solid growth performance was accompanied by fiscal consolidation with the deficit declining from 5.6% of GDP in 1995 to 2.3% and 1.0% of GDP on average in the periods 1996-2000 and 2001-2005 respectively. The significant drop in the deficit ratios was a result of a series of stop-and-go consolidation efforts. The expenditure and revenue to GDP ratios, as well as tax burden remained high in comparison to other Euro area countries. While the expenditure ratio kept falling almost continuously throughout the last decade, the revenue ratio and tax burden have only been on a clearly downward trend since 2001.



**Figure 1: Average GDP growth: Austria vs. EU25 and euro area**

**Figure 2: Deficit as percent of GDP**

*Source: Commission Services*

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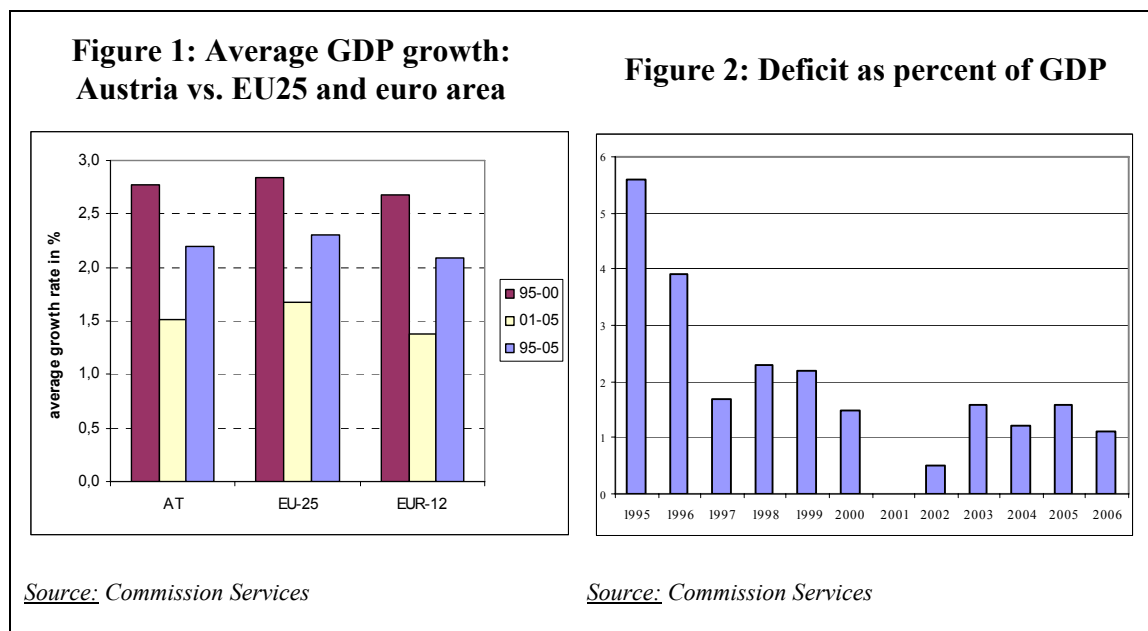
Austria benefited spectacularly from the opening-up of Central and Eastern Europe in 1989. Estimates produced by WIFO, the leading economic research institute in Austria, point to an impact of this opening-up of some ½ % of additional average economic growth per year and a total of 77 thousand new jobs[3]. Austria is also the country which profits most of all "old" EU Member States from the EU enlargement of 2004. According to WIFO, the addition of 10 members to the EU results in the annual growth of Austrian real GDP being higher by 0.2 percentage points in the 10 years following the enlargement.

The economic growth in the last decade was relatively poor in job creation, as employment in Austria, at 0.6% p.a. grew only at half the pace compared with the euro area average; a gap which, moreover widened in the last five years. In spite of the weak job creation, Austria has enjoyed one of the lowest unemployment rates among the euro area members. At 4.3% of the labour force on average in the last 10 years, the Austrian rate was less than half of the EU-12 average rate. However, the gap started narrowing towards the end of the decade as sluggish labour demand was compounded by rising supply, due to increased immigration, more women entering the labour force and older workers staying longer in jobs as a consequence of a major pension reform. In spite of the latter taking effect, the employment rate of older workers in Austria is still dramatically low. At 31.8% in 2005, it was the third lowest in the EU, with only Poland

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[3]  Breuss, F. (2006), Ostöffnung, EU-Mitgliedschaft, Euro-Teilnahme und EU-Erweiterung: Wirtschaftliche Auswirkungen auf Österreich, WIFO Working Papers 270

and Slovakia scoring worse, and by almost 9 percentage points below the euro area's average. Nevertheless, Austria enjoys one of the highest rates of overall employment because of relatively high female and youth employment rates[4].

The Austrian inflation rate, measured by the harmonised consumer price index, was continuously lower than that of the euro area, by 0.3 percentage point on average. The country's good performance in terms of low inflation is traditionally ascribed to the continuation of the stability-oriented monetary policy and moderation in wage-setting. Austrian competitiveness was enhanced in the last decade as labour productivity increases were significantly higher than in other EMU members on average and as a result, real unit labour costs declined almost twice as fast as in the euro area on average.

## 2.2. Anatomy of medium-term growth

Within the framework of a traditional growth accounting exercise, this section dissects the sources of Austrian average growth as well as possible differences in average economic growth vis-à-vis the euro area. The growth accounting exercise is carried out on the basis of a Cobb-Douglas production function.

As shown in Figure 3, taking into account the last ten years, like in the most other European countries, the increase in total factor productivity was the main driver behind the growth of the Austrian economy. Capital deepening and changes in the labour market conditions contributed to the expansion to a lesser extent. However, the story changed from the first half to the second half of the last decade. Whereas TFP was a clearly dominating factor in the first five years, its contribution to growth dropped significantly in the remaining part of the period. The latter saw capital deepening and growing working age population as the main drivers of growth.

Despite this fact of its declining contribution to GDP growth, TFP still contributes more compared to other euro area economies. As can be seen from Figure 4, besides the growing working age population, TFP and capital deepening have been stronger growth drivers in Austria compared with the euro area. Austria has significantly increased spending on R&D in the last decade (from 1.6% of GDP in 1996 to 2.4% of GDP in 2005). However, what mainly fed the TFP growth were not spectacular advances in high-tech industries, but incremental innovations carried out by medium-tech manufacturing companies whose share in Austria's industrial structure is high by international comparison[5]. Capital deepening, which drove GDP growth in the last five years, can to a large extent be explained by the taxation system favouring capital accumulation[6]. The strong growth of the working age population was mainly caused by the inflow of migrants, in particular from Germany.

**Figure 3: Real GDP growth and its components**

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[4] It must be noted, though, that the Austrian employment rate of 15-24 year olds is heavily influenced by the high number of apprenticeships.

[5] Gnan, E. et al (2004), "Determinants of Long-Term Growth in Austria – A Call for a National Growth Strategy" in *Monetary Policy and the Economy Q1*, Österreichische Nationalbank.

[6] During the last years, taxes levied on corporative and capital income were lower compared to the labour tax burden.
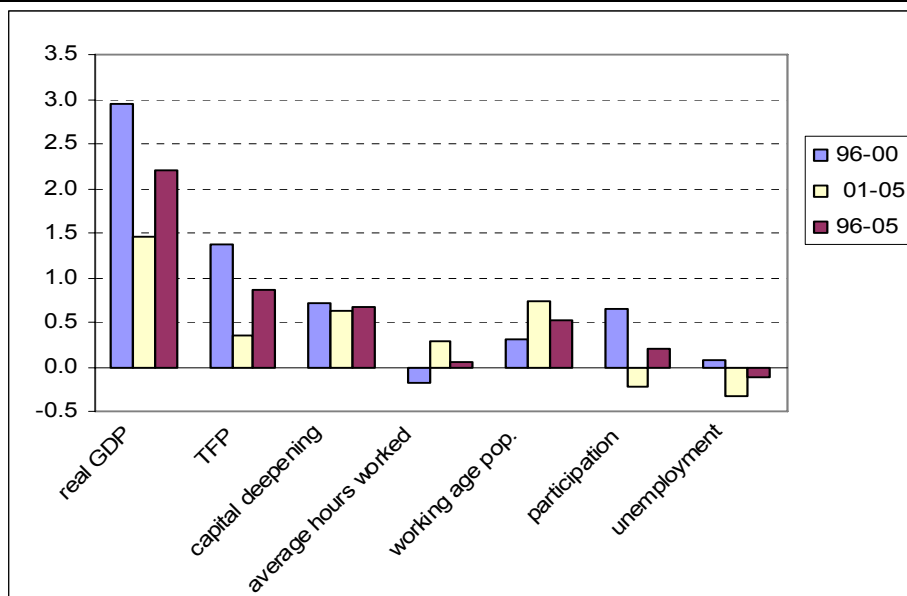
Note:

Assuming a Cobb-Douglas-production function $Y = A(L \cdot H)^\alpha K^{1-\alpha}$ where $Y$ denotes the level of *GDP*, $L$ employment, $H$ the average hours worked per person employed, K the capital stock and $\alpha$ the labour share in income, real GDP can be written as $Y = \dfrac{Y}{H \cdot L} H \cdot L = A \cdot \left(\dfrac{K}{H \cdot L}\right)^{1-\alpha} H \cdot WP \cdot PART \cdot (1 - ur)$ where *WP* stands for working age population, *PART* denotes the participation ratio as a share of *WP* and *ur* the rate of unemployment. In terms of growth rates *g* this is:

$$g_Y = g_A + (1-\alpha)(g_K - g_L - g_H) + g_H + g_{WP} + g_{PART} - g_{ur} \cdot \frac{ur}{1-ur}$$

The expression $(g_K - g_L - g_H)$ is referred to as capital deepening, i.e. the increase in the capital labour ratio.

*Source: Commission services*

As mentioned above, in the course of the last decade, Austria saw a slightly higher real GDP growth than the euro area average. Higher average hours worked and a growing working age population were mainly responsible for Austria experiencing higher real GDP growth. However, especially in the second part of this decade, the growth contribution of workers' participation lagged behind the countries of the euro area. Similarly, the high unemployment rate had a comparatively braking effect on Austrian growth, but with visible improvements in the last years.

**Figure 4:  Real GDP growth and its components: Difference vis-à-vis euro area**

Note: See note of Figure 3

*Source: Commission Services*
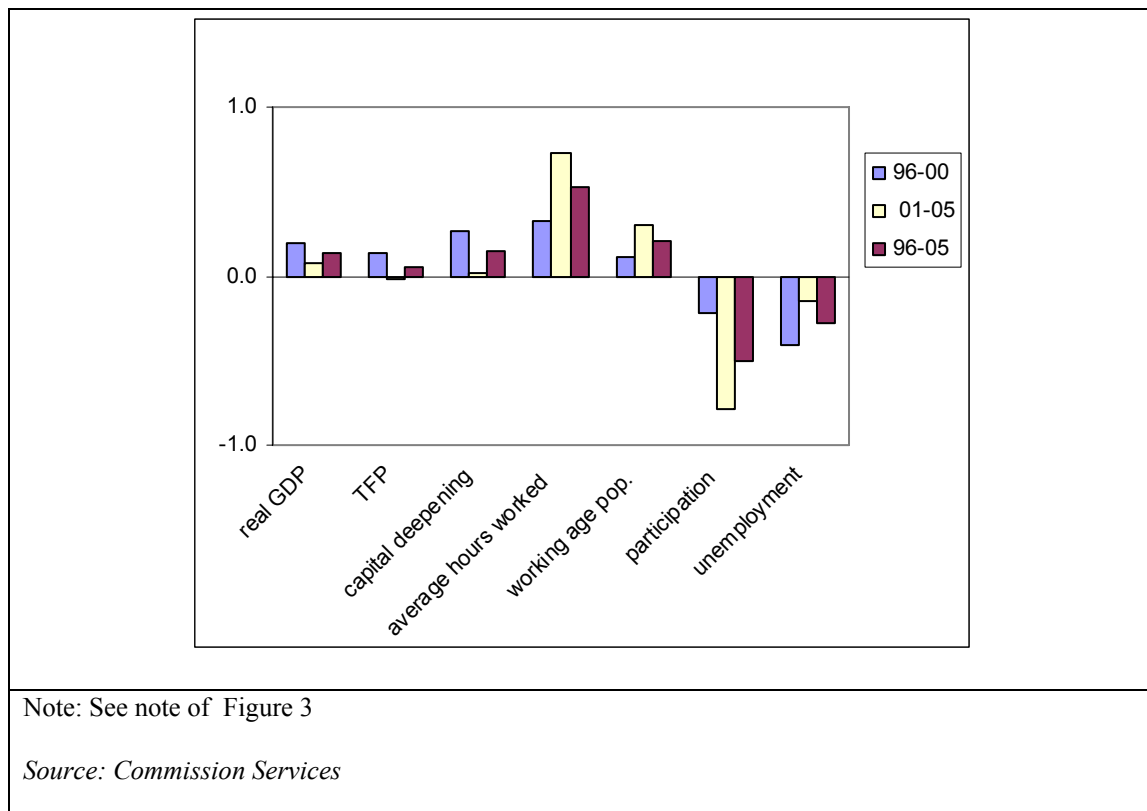
## 2.3. Macro-policies against the backdrop of the economic cycle

In the decade up to 2005, Austrian real GDP growth was slightly more volatile than that of the euro area average, but its peaks and troughs largely reflected developments in the EU12. The output gap profiles of Austria and the euro area were quite similar as well (see Figure 5). With the exception of the weak period from 2001 to 2003, Austrian annual GDP growth has been quite robust, oscillating between 1.8% and 3.6

The second half of the decade showed a smaller contribution of domestic demand compared to the years before. This was a reflection of dramatically reduced private consumption and the fact that the contribution of investment actually became negative. It turned out that both components remained largely unresponsive to the government's discretionary measures. Following the tax cuts introduced in 2004 and 2005, consumption growth edged up marginally, but it was a predominantly cyclical phenomenon and largely irrelevant by historical standards. After all the tax cuts did not have the intended counter-cyclical stabilisation effect as net income gains were largely saved. The fiscal investment premium, introduced in 2002 which was offered for three years resulted mainly in significant carry-forward effects, but not – as the authorities expected – in a great deal of additional investment.

In the course of the last decade, HICP inflation in Austria was also more volatile (but lower in all years) than the euro area average. In contrast, Austria experienced a much more stable (and lower) unemployment rate.

With the exception of the 1998-2000 episode, the fiscal stance, measured as a change in the cyclically-adjusted primary balance, was counter-cyclical throughout the whole decade (see Figure 5). The 1998-2000 period is referred to in the literature as a

"consolidation pause"[7]. The fact that Austria qualified for the EMU membership, having lowered the nominal general government deficit from 3.9% of GDP in 1996 to 1.7% in 1997, took away the urgency of introducing further consolidation measures. On top of that, as parliamentary elections approached in 1999, the government came up with an initiative introducing a tax reform that was to burden the budget with a cost of about 0.9% of GDP, but which was not matched by expenditure cuts.

**Figure 5: Output gap and fiscal stance**

**Figure 6: Output gap and monetary conditions**
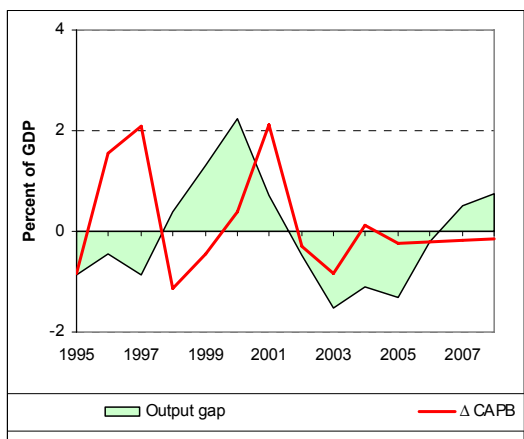
*Note:* ΔCAPB denotes the change in the cyclically-adjusted primary budget balance.

*Source:*
*Commission Services*
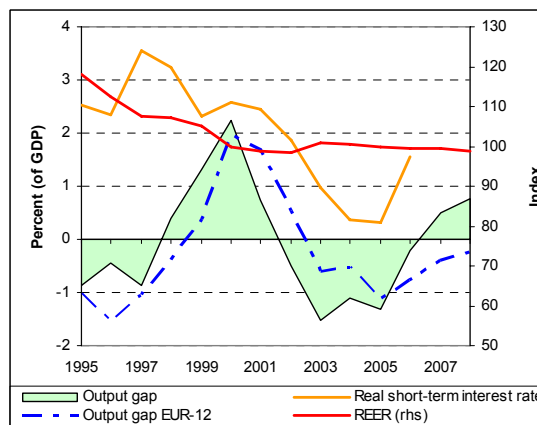
*Source:*
*Commission Services*

As illustrated in Figure 6, Austria's real effective exchange rate went down in all but one year of the last decade, favouring the country's export performance. The exception was the year 2003, which coincided with the lowest growth of exports of goods and services Austria has experienced in the last ten years. The real short-term interest rate has been on a largely declining trend since 1997, however with some fluctuations. In broad terms, it can be said that monetary conditions as measured by the real short-term interest rate were supportive to Austria's GDP growth.

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[7]  Katterl, A., W. Köhler-Töglhofer (2005), "The Impact of EU Accession on Austria's Budget Policy", *Monetary Policy and the Economy Q2*, Österreichische Nationalbank, p.107.

### 2.4. Public finances

Austria's budgetary policy in the last decade was shaped by the realization in the mid-1990s that unless some radical steps were taken, the already high public debt would get out of control. This coincided with the country's desire to be among the founding members of the EMU. As the budget deficit and public debt reached their record highs at 5.6% and 67.9% of GDP respectively in 1995, it became obvious that the policy needed to be changed radically in order to make public finances sustainable again. As a result, a consolidation package was introduced resulting in the general government deficit going down significantly in the two following years (by almost 4 % of GDP in total), paving the way for Austria's membership of the EMU. Unfortunately, consolidation efforts stalled subsequently and public finances relapsed into a substantially higher deficit as early as 1998. The window of opportunity created by strong GDP growth at the end of the 1990s was not taken advantage of.

The 2000-2005 period was characterized by relatively more sustained efforts to consolidate public finances. The new government arriving in office in 2000 set an ambitious goal of balancing the general government budget each year from 2002 onwards. Indeed such a scenario materialised one year earlier than planned, but was mainly based on measures increasing tax revenue. This, however, resulted in the tax burden reaching its highest level (46.5% of GDP) in Austria's post-war history. In 2002, due to the slowdown in the world economy and costs of severe flood damages in Austria, the goal of balancing budgets on a yearly basis was replaced by the intention to balance them over the economic cycles.

What followed was, on the one hand, the introduction of a series of major reforms in the fields of public administration, pension and health care aimed at alleviating the general government balance, but, on the other hand, the newly designed tax reform putting a substantial strain on it. According to the Ministry of Finance, the administrative reform of 2000-2006 was supposed to carry savings of 3% of GDP. The impact of the 2003/2004 pension reform is difficult to quantify, but there is a consensus that it contributed substantially to enhancing sustainability of the Austrian public finances by providing for significant expenditure cuts in the medium and long-term. However, having closed some of the early retirement channels, the recent reforms opened others, i.e. by making access to disability pensions much easier for unskilled workers aged 57 and more, by introducing an early retirement option for people involved in onerous work and by modifying the old-age part-time employment schemes in a way that allowed phases of work and inactivity to be grouped in blocks opening effectively yet another channel for early retirement.[8] The 2005 health care reform partially addressed inefficiencies in the supply of medical care in Austria. The 2004/2005 tax reform was inspired by the fact that - as mentioned above – the tax burden reached a record level. However, as the tax cuts were not fully underpinned by offsetting expenditure cuts, the budget balance kept drifting away from the goal of balancing it over the business cycle.

All in all, the whole decade was characterized by stop-and-go consolidation efforts. Having reached a record high level of 5.6% of GDP in 1995, the general government deficit declined to 2.3% and 1.0% of GDP on average in the periods 1996-2000 and

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[8] Sherwood, M. (2006), "Unemployment in Austria: low, but…", *ECFIN Country Focus,* Vol. III, available at: http://ec.europa.eu/economy_finance/publications/country_focus/2006/countryfocus2006_en.htm.

2001-2005 respectively. Government expenditure as percentage of GDP has been on a broadly declining trend throughout the last ten years, falling from 55.4% in 1996 to 49.8% in 2005. The revenue ratio also went almost continuously down but by a smaller margin than the expenditure ratio. Having dropped by 3.2 percentage points over the decade, the former reached 48.2% in 2005. Following the 2004/2005 tax reform, the tax burden declined by 2.7 percentage point from its peak in 2001 to reach 43.8% of GDP in 2005.

During the last decade expenditures for general public services and interest payments which constitute the biggest part of general government expenditure, were lowered from 17.4 billion Euro in 1998 to 16.9 billion Euro in 2003. On the other hand, a relative increase on expenditure on Education, Economic affairs and Environmental protection was seen.

Public debt, starting from its record high in 1995 (67.9% of GDP), went down by an impressive 4% of GDP by 1997, mirroring the above-mentioned consolidation effort. The debt then bounced back up by 2.7% of GDP. Since 1999 it has been declining almost continuously but in a very incremental manner to reach 63.5% of GDP in 2005. The gradual reduction in debt ratio was helped by the falling cost of servicing it as interest rates went down with the arrival of the EMU. In fact, in the course of the last decade, interest payments decreased by 1% of GDP.

Up to now, Austria has had a mixed record in terms of fulfilling its commitments presented in subsequent updates of the stability programme (see Figure 7), but it has got better with time. It is noteworthy that in the last three years the general government balance turned out more positive than predicted in the updated programme submitted in that respective year.

**Figure 7: General government balance projections in successive stability programmes (% of GDP)**
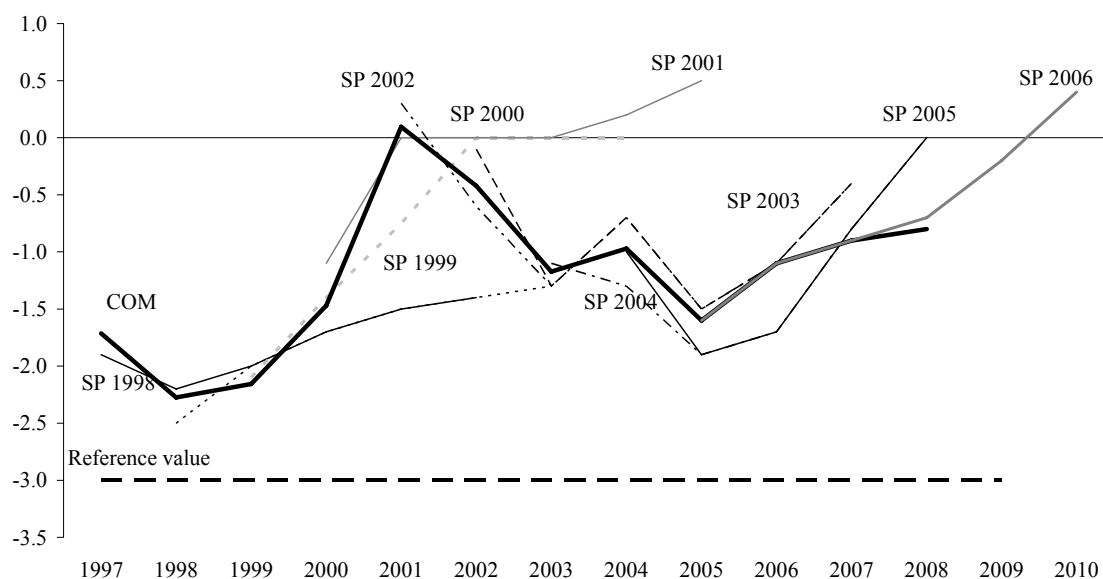


Source: Commission services' spring 2007 forecast (COM) and successive stability programmes

Worth of mentioning in the context of the Austrian public finances is the country's national stability pact. Concluded informally for the first time in the run-up to the EMU in 1996, this mechanism for coordination of fiscal consolidation efforts between the different layers of government has since then seen its two new formal editions (for the periods 2001-2004 and 2005-2008). It essentially prescribes central government deficit limits for the respective years and obliges the lower levels of government to make "stabilisation" contributions by closing their annual accounts either with balance or a certain surplus. In spite of some controversies that arose about the way the pact has been implemented, overall it seems that it has played a major role in disciplining the different actors.

## 2.5. Medium and long-term policy challenges for public finances

In the last decade the Austrian economy developed in a rather stable manner. Real GDP growth slowed down substantially in the period 2001-2003, largely a reflection of the global and in particular euro area economic weakening rather than of some kind of home-made crisis deriving from specific national instabilities. Thanks to its geographical position, Austria was able to reap substantial benefits first from the opening-up of Central and Eastern Europe and second from the EU accession of the 10 new countries. The country has enjoyed one of the lowest unemployment and inflation rates in the euro-area. Due to its long-established consensus-orientated and highly centralised wage setting policy, Austria managed to lower its unit labour costs faster than the euro-area members on average, which greatly enhanced the country's competitive position.

In terms of public finances, Austria experienced some substantial consolidation efforts in the last ten years, reducing the high general government budget deficit by mid 90s, leading to a neutral position in 2001 and relapsing into a small deficit in the years after. Many significant reforms aimed at reducing the general government deficit have been introduced, i.e. those of public administration, pension and health care. But there still

remains room for improvement in all those and other areas, presenting the following challenges:

- sustainability of public finances:

In Austria the employment rate of workers aged 55 and above is the third lowest in the EU after Poland and Slovakia. Increasing work incentives for older workers would not only increase the productive potential, but at the same time strengthen long-term sustainability of the pension system. Moreover, the harmonisation of pension schemes for public sector employees with that for the private sector needs to be completed, which would generate further savings in the long run. Likewise ongoing reforms in the health care system are important for supporting the long-term sustainability of public finances (see Chapter 5 below).

- efficiency by improving the quality of public spending:

Public investments in R&D have risen as a percentage of GDP since the year 2000. Further efforts in this area will contribute to a higher long-run growth path. The introduction of a medium-term budgetary planning framework for the federal government would make the development of public finances more predictable. The reform of the budgetary law by introducing the medium-term framework still awaits legislation.

## Table 1: Key economic indicators

| | Austria | | | | | | Euro area | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Averages** | | | 2003 | 2004 | 2005 | **Averages** | | | 2003 | 2004 | 2005 |
| | '96 - '05 | '96 - '00 | '01 - '05 | | | | '96 - '05 | '96 - '00 | '01 - '05 | | | |
| **Economic activity** | | | | | | | | | | | | |
| Real GDP (% change) | 2.2 | 2.9 | 1.5 | 1.1 | 2.4 | 2.0 | 2.1 | 2.7 | 1.4 | 0.8 | 2.0 | 1.4 |
| Contributions to real GDP growth: | | | | | | | | | | | | |
| *Domestic demand* | 1.5 | 2.3 | 0.8 | 2.3 | 1.5 | 1.2 | 2.0 | 2.7 | 1.3 | 1.4 | 1.8 | 1.6 |
| *Net exports* | 0.6 | 0.6 | 0.7 | -1.3 | 0.9 | 0.9 | 0.1 | 0.1 | 0.1 | -0.7 | 0.2 | -0.2 |
| **Prices, costs and labour market** | | | | | | | | | | | | |
| HICP inflation (% change) | 1.6 | 1.2 | 1.9 | 1.3 | 2.0 | 2.1 | 1.9 | 1.7 | 2.2 | 2.1 | 2.1 | 2.2 |
| Labour productivity (% change) | 1.6 | 2.2 | 1.0 | 0.9 | 2.1 | 0.7 | 1.2 | 1.5 | 0.8 | 0.8 | 1.6 | 0.9 |
| Real unit labour costs (% change) | -0.9 | -1.0 | -0.9 | -0.3 | -2.1 | -0.9 | -0.5 | -0.6 | -0.5 | -0.1 | -1.0 | -0.8 |
| Employment (% change) | 0.6 | 1.0 | 0.2 | 0.1 | 0.0 | 0.3 | 1.2 | 1.5 | 0.9 | 0.7 | 0.7 | 0.8 |
| Unemployment rate (% of labour force) | 4.3 | 4.1 | 4.4 | 4.3 | 4.8 | 5.2 | 9.1 | 9.8 | 8.5 | 8.7 | 8.9 | 8.6 |
| **Competitiveness and external position** | | | | | | | | | | | | |
| Real effective exchange rate (% change) (1) | -1.7 | -3.3 | -0.1 | 2.6 | -0.3 | -1.0 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Export performance (% change) (2) | 0.6 | -0.4 | 1.6 | -2.4 | 1.6 | 0.2 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| External balance (% of GDP) | 0.1 | -1.4 | 1.6 | 1.7 | 1.9 | 2.8 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Public finances** | | | | | | | | | | | | |
| General government balance (% of GDP) | -1.6 | -2.3 | -1.0 | -1.6 | -1.2 | -1.5 | -2.3 | -2.1 | -2.5 | -3.1 | -2.8 | -2.4 |
| General government debt (% of GDP) | 65.1 | 65.6 | 64.7 | 64.6 | 63.8 | 63.4 | 70.9 | 72.5 | 69.3 | 69.3 | 69.8 | 70.8 |
| Structural budget balance (% of GDP) (3) | n.a. | n.a. | n.a. | -0.9 | -0.7 | -0.9 | n.a. | n.a. | n.a. | -3.2 | -2.9 | -2.0 |
| **Financial indicators (4)** | | | | | | | | | | | | |
| Long term real interest rate (%) (5) | 3.7 | 4.6 | 2.7 | 2.8 | 2.4 | 1.5 | 3.1 | 4.1 | 2.1 | 2.0 | 2.2 | 1.5 |
| Household debt (% of GDP) (6) | n.a. | 44.542 | n.a. | 48.2 | 50.3 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Corporate sector debt (% of GDP) (7) | 73.362 | 68.72 | 78.004 | 79.3 | 76.2 | 77.5 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |

Notes:

More detailed tables summarising the economic performance of the country are included in Annex 4.

(1) Unit labour costs relative to rest of a group of industrialised countries (USD): EU24 (=EU25 excl. LU), BG, RO, TR, CH, NR, US, CA, JP, AU, MX and NZ.

(2) Market performance of exports of goods and services on export weighted imports of goods and services of 35 industrial markets.

(3) Cyclically-adjusted budget balance net of one-off and other temporary measures.

(4) Data available up to 2005.

(5) Using GDP deflator.

(6) Households' and non-profit institutions serving households' debt, defined as loans and securities other than shares.

(7) Non-financial corporate sector debt, defined as loans and securities other than shares.

*Source :*

*Commission services*

## 3. MACROECONOMIC OUTLOOK

This section is in seven parts, six of which refer to various dimensions of the macroeconomic scenario, notably: the external assumptions, economic activity, potential output growth, the labour market, costs and prices and sectoral balances. The final part summarises the assessment and includes (i) an overall judgement on the plausibility of the macroeconomic scenario and (ii) an indication of whether economic conditions over the programme period can be characterised as economic 'good' or 'bad' times.

### 3.1. External assumptions

The macroeconomic outlook for the update of the programme is based on forecasts from the Austrian Institute of Economic Research (WIFO). The figures for 2007 and 2008 correspond to those of the WIFO December 2006 forecast. Projections for 2009 and 2010 are derived from the WIFO model-based forecast as of early February 2007. The underlying external assumptions of the programme were submitted to the Commission by the Austrian authorities separately. The programme foresees ongoing growth for the world economy (excl.EU-25) and the EU-25 (estimated at 5¼ % and 2½ %, respectively). This is slightly less optimistic compared with the Commission services' spring 2007 forecast. Assumptions on short- and long-term interest rates for Austria are broadly in line with the Commission.

Besides the higher US-Dollar exchange rate assumption in the programme, there are some discrepancies concerning projections on oil prices between the external assumptions underlying the programme and the recent Commissions services' forecast. The programme expects an average oil price close to 63 US-Dollar per barrel over the years 2006-2010, with price projections of around 61 US-Dollar for 2007 and 2008. In contrast, underlying the Commissions services' spring forecast are higher projected prices (66 US-Dollar in 2007 and 70 US-Dollar per barrel in 2008).

### 3.2. Economic activity

According to the update, real GDP growth is expected to grow at an annual rate of 2.7 % in 2007 and 2.3 % in 2008. Given new data published in the first quarter of the year, the short-term scenario can be considered as somewhat cautious, but broadly in line with Commissions' services spring 2007 forecast (see Table 2).

The differences in the projected GDP growth rates result from the programme's slightly more pessimistic outlook for the gross fixed capital formation and exports of goods and services in the years 2007 and 2008. Business surveys in the first quarter, which were already taken into account for in the Commissions' services spring 2007 forecast, show continued optimism especially for firms in the manufacturing and construction sector, suggesting the brisk investment to continue in 2007. Compared with the Commission services' spring forecast, the programme's less favourable export forecast is consistent with the different external assumptions (less optimistic outlook for the EU and higher exchange rates vis-à-vis the US-Dollar).[9] According to the programme, private

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[9] The programme presents a sensitivity analysis assuming higher growth in export markets by 0.5 percentage points per year. This would increase real GDP by about ¼ percentage point. The impact on the government balance would also be positive according to that scenario, although export-driven growth is generally not tax-revenue-rich.

consumption would rise moderately at around 2 % in both years, which is in line with the Commissions' services spring 2007 forecast. The main contribution to real GDP growth derives from final domestic demand in both the programme and the Commission services' forecast, while the latter foresees in addition a positive contribution from external demand, which is neutral according to the programme.

For the outer forecast years 2009-2010, the programme projects real GDP growth at around 2½ % each year. This seems plausible, even if the growth rates are somewhat higher than the average potential growth rates calculated by the Commission services. The components of growth seem consistent with the price developments and the external assumptions underlying in the programme.

Commission services' calculations for the output gap based on the medium-term projections in the programme and using the commonly agreed method suggest that the output gap will close in 2007 but open slightly again in 2008 (-0.1%). The result differs from that based on the Commission services' spring forecast, which shows an improvement from 2006 onwards. This difference stems from the more optimistic growth outlook in combination with the yet lower underlying growth potential projected by the spring forecast.

Table 3 indicates that the perception of Austria's economic conditions changed between autumn 2005 (showing negative gaps), and the following year, where the situation improved markedly. A revision of output gap estimates took place in both the Commission services' forecast as well the stability programme updates.

**Table 2: Comparison of macroeconomic developments and forecasts**

| | 2006 | | 2007 | | 2008 | | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| | COM | SP | COM | SP | COM | SP | SP | SP |
| Real GDP (% change) | 3.1 | 3.1 | 2.9 | 2.7 | 2.5 | 2.3 | 2.5 | 2.6 |
| Private consumption (% change) | 1.8 | 1.8 | 2.0 | 2.1 | 2.1 | 2.0 | 2.0 | 2.0 |
| Gross fixed capital formation (% change) | 4.7 | 4.7 | 5.2 | 4.9 | 3.2 | 3.4 | 3.0 | 2.9 |
| Exports of goods and services (% change) | 8.5 | 8.5 | 7.4 | 7.1 | 6.9 | 6.2 | 6.2 | 6.6 |
| Imports of goods and services (% change) | 6.8 | 6.8 | 7.3 | 7.7 | 6.7 | 6.6 | 6.0 | 6.0 |
| *Contributions:* | | | | | | | | |
| - Final domestic demand | 1.9 | 1.9 | 2.5 | 2.5 | 2.2 | 2.2 | 1.8 | 2.1 |
| - Change in inventories | -0.1 | -0.1 | 0.0 | 0.1 | -0.2 | 0.0 | 0.2 | -0.2 |
| - External balance on g&s | 1.3 | 1.3 | 0.4 | 0.1 | 0.5 | 0.1 | 0.4 | 0.7 |
| Output gap[1] | -0.2 | -0.3 | 0.5 | 0.1 | 0.8 | -0.1 | 0.1 | 0.3 |
| Employment (% change) | 1.4 | 1.6 | 1.4 | 1.3 | 0.7 | 0.7 | 0.7 | 0.7 |
| Unemployment rate (%) | 4.8 | 4.8 | 4.4 | 4.5 | 4.3 | 4.2 | 4.1 | 3.9 |
| Labour productivity growth (%) | 1.9 | 1.5 | 1.7 | 1.4 | 1.8 | 1.6 | 1.8 | 1.9 |
| HICP inflation (%) | 1.7 | 1.5 | 1.8 | 1.6 | 1.7 | 1.7 | 1.7 | 1.8 |
| GDP deflator (% change) | 1.5 | 1.3 | 1.8 | 1.7 | 1.7 | 1.7 | 1.2 | 1.3 |
| Comp. of employees (per head;% change) | 2.3 | 3.0 | 2.4 | 2.6 | 2.5 | 2.5 | 2.6 | 2.9 |
| Real unit labour costs (% change) | -1.1 | 0.0 | -1.1 | -0.5 | -1.0 | -0.8 | -0.6 | -0.4 |
| External balance (% of GDP) | 3.5 | 1.9 | 3.2 | 1.8 | 3.0 | 1.9 | 1.9 | 1.9 |
| Note: | | | | | | | | |
| [1]In percent of potential GDP, with potential GDP growth as reported in Table 2 below. | | | | | | | | |
| *Source:* | | | | | | | | |
| *Commission services' spring 2007 economic forecasts (COM); Stability programme* | | | | | | | | |

**Table 3: Output gap estimates in successive Commission services' forecasts and stability programmes**

|  | 2006 | | 2007 | | 2008 | |
|---|---|---|---|---|---|---|
|  | COM | SP[1] | COM | SP[1] | COM | SP[1] |
| Spring 2007 | -0.2 |  | 0.5 |  | 0.8 |  |
| Mar. 2007 |  | -0.3 |  | 0.1 |  | -0.1 |
| Autumn 2006 | -0.2 |  | 0.2 |  | 0.0 |  |
| Spring 2006 | -0.4 |  | -0.3 |  | 0.0 |  |
| Nov. 2005 |  | -1.1 |  | -0.9 |  | -0.5 |
| Autumn 2005 | -1.0 |  | -0.9 |  | 0.0 |  |
| Spring 2005 | -0.4 |  | 0.0 |  | 0.0 |  |
| SP Dec. 2004 |  | -0.4 |  | -0.3 |  | 0 |

Note:

[1] Commission services' calculations according to the commonly agreed method based on the information in the programme.

*Source: Commission services' forecasts, national Stability programme and Commission services.*


## 3.3. Potential growth and its determinants

Based on the information provided in the programme, Commission services' calculations according to the commonly agreed methodology indicate potential output at around 2.3% (Table 4). These calculations are slightly above the Commission services' spring forecast (2.2% for 2007 and 2008). The difference comes from the more favourable projections of the structural unemployment rate as well as of the trend participation rate underlying the update, leading to a higher contribution of labour to potential growth in the estimation based on the information in the programme. In both projections, potential growth is expected to rely on higher contributions from capital formation and investment compared with that from labour.


**Table 4: Sources of potential output growth**

|  | 2006 | | 2007 | | 2008 | | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
|  | COM | SP[2] | COM | SP[2] | COM | SP[2] | SP[2] | SP[2] |
| Potential GDP growth[1] | 2.2 | 2.3 | 2.2 | 2.3 | 2.2 | 2.4 | 2.4 | 2.3 |
| *Contributions:* | | | | | | | | |
| - Labour | 0.4 | 0.5 | 0.3 | 0.4 | 0.3 | 0.4 | 0.3 | 0.2 |
| - Capital accumulation | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.9 | 0.9 |
| - TFP | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 | 1.3 |

Notes:

[1] based on the production function method for calculating potential output growth

[2] Commission services' calculations on the basis of the information in the programme

*Source:*

*Commission services' spring2007 economic forecasts (COM); Commission services' calculations*


## 3.4. Labour market developments

In 2006, lively activity gave impetus to the labour market. The programme expects employment to remain upward-bound with an increase of 1.3% and 0.7% in 2007 and 2008, respectively. Due to the increase in the labour supply, the unemployment rate is

expected to fall only slowly. Both employment and unemployment projections until 2008 are in line with the Commission services' spring forecast. The programme states the government objective to bring the unemployment rate below 4% and raise the participation rate of women above 65% by 2010.

Given the medium-term growth path in the programme, lowering the unemployment rate below 4% may be regarded as ambitious, also in view of the possible introduction of planned policy measures, which might impact on labour supply. The planned new childcare allowance, which is not yet considered in the programme, could raise labour supply in 2008 and after, which might counter the projected reduction in the unemployment rate somewhat.[10]

The participation rate of women is currently upward-bound. Given the macroeconomic developments, the objective to reach 65% by 2010 can be regarded as plausible.

## 3.5.    Costs and price developments

Inflation developments presented in the programme are in line with the Commission services' spring forecast. Price increases are expected to remain moderate in 2007 and 2008, as wage developments are staying in line with gains in productivity. According to the Commission service's forecast, a slightly higher cyclical upturn is more likely to be accompanied by slightly higher wage growth compared with the programme's projections. The programme assumes a trend continuation of a slightly improving external price competitiveness vis-à-vis EU member states.

## 3.6.    Sectoral balances

The projections on the net lending vis-à-vis the rest of the world (but without a more detailed breakdown) show an improvement in the current account over the programme period. In the text, the programme cites Austria's favourable external competitiveness vis-à-vis Germany, its main trading partner, leading to the excellent export performance.

## 3.7.    Assessment

The assessment of the macroeconomic outlook covers two questions: first, whether the macroeconomic scenario is plausible, and, second, whether the economy should be considered to be in economic 'good' or 'bad' times.

### 3.7.1.    *Plausibility of the macroeconomic scenario*

The programme's growth figures for 2007 and 2008 correspond to those of WIFO's December 2006 forecast. Estimates for 2009 and 2010 are derived from their model based forecast (as of early February 2007). The programme suggests economic activity to remain buoyant with an average GDP growth rate of 2.5%, and a yearly employment growth of 1% during the forecast horizon. The main contribution stems from domestic demand. Caused by the brisk investment activity, the strong economic dynamics of 2006 are expected to continue with real GDP growing by 2.7% in 2007, whereas the economy is losing momentum in 2008. Due to the increase in the labour supply, unemployment

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[10]    The plan foresees a higher amount and shorter time-frame period allowing more flexibility, possibly starting in 2008.

rate is expected to fall only slowly. The programme assumes moderate price and wage increases.

Generally, the programme's macroeconomic assumptions appear to be plausible. For the years 2007 and 2008, the projections of GDP growth can even be considered as slightly cautious as they are slightly below the Commissions' services spring 2007 forecast, which took more recent data into account. There are slight but no major differences concerning the composition of growth and price developments. Likewise, the programme's projection for the outer forecast years 2009-2010 can be considered plausible, even if the projected growth rates are somewhat higher than the average potential growth rates calculated by the Commission services.

### 3.7.2.  *Economic good vs. bad times*

At the moment Austria is experiencing a period of economic good times. The output gap had improved and almost closed in 2006. According to the Commission services' spring forecast it is expected to turn positive in 2007 and 2008 (+0.5% and +0.8% respectively). Also the labour market is showing a marked improvement, underpinning the favourable cyclical situation. For the period beyond 2008, the update expects the output gap to remain positive with further employment increase.


## 4.  GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2006 and the second presents the budgetary strategy in the new update, including the programme's medium-term objective (MTO) for the budgetary position. The third analyses the risks attached to the budgetary targets in the programme. The final part contains the assessment of the fiscal stance and of the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

As mentioned above, budgetary projections from the programme – as displayed in Tables 5, 6 and 8 below - were revised by the Ministry of Finance after the submission of the programme. The revision was submitted to the Commission on 25 April 2007, i.e. one month after the programme update.

### 4.1.  Budgetary implementation in 2006

In 2006, the general government deficit, amounting to 1.1% of GDP, turned out lower than targeted in the November 2005 update (1.7%). This improvement over the target results from the better-than-expected cyclical position. The previous update projected a decline in the revenue-to-GDP ratio between 2005 and 2006, while in fact the decline turned out less pronounced than projected, reflecting a higher tax-intensity of economic growth. However, the expenditure ratio was projected to decline by a full percentage point between 2005 and 2006, while in fact it declined by less – despite GDP growth higher than expected. This points to budgetary slippage in 2006.

**Table 5: Evolution of budgetary targets in successive programmes**

|  |  | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| General government balance (% of GDP) | **SP Mar. 2007** | - | -1.1 | -0.9 | -0.7 | -0.2 | 0.4 |
|  | SP Nov. 2005 | -1.9 | -1.7 | -0.8 | 0.0 | n.a. | n.a. |
|  | *SP Dec 2004* | -1.9 | -1.7 | -0.8 | 0 | - | - |
|  | COM May 2007 | -1.6 | -1.1 | -0.9 | -0.8 | n.a. | n.a. |
| General government expenditure (% of GDP) | **SP Mar. 2007** | - | 49.2 | 48.7 | 48.3 | 47.5 | 46.9 |
|  | SP Nov. 2005 | 49.5 | 48.5 | 47.6 | 46.7 | n.a. | n.a. |
|  | *SP Dec 2004* | 49.5 | 48 | 46.7 | 45.8 | - | - |
|  | COM May 2007 | 49.9 | 49.2 | 48.4 | 48.0 | n.a. | n.a. |
| General government revenues (% of GDP) | **SP Mar. 2007** | - | 48.0 | 47.6 | 47.4 | 47.2 | 47.1 |
|  | SP Nov. 2005 | 47.6 | 46.9 | 46.8 | 46.7 | n.a. | n.a. |
|  | *SP Dec 2004* | 47.5 | 46.2 | 46 | 45.8 | - | - |
|  | COM May 2007 | 48.2 | 48.0 | 47.4 | 47.1 | n.a. | n.a. |
| Real GDP (% change) | **SP Mar. 2007** | 2.0 | 3.1 | 2.7 | 2.3 | 2.5 | 2.6 |
|  | SP Nov. 2005 | 1.7 | 1.8 | 2.4 | 2.5 | n.a. | n.a. |
|  | *SP Dec 2004* | 2.5 | 2.5 | 2.2 | 2.4 | - | - |
|  | COM May 2007 | 2.0 | 3.1 | 2.9 | 2.5 | n.a. | n.a. |

Note:
*Source:*
*Stability programme (SP); Commission services' spring 2007 economic forecasts (COM)*

## 4.2. The programme's medium-term budgetary strategy

This section covers in turn the following aspects of the medium-term budgetary strategy outlined in the programme: (i) the main goal of the budgetary strategy; (ii) the composition of the budgetary adjustment, including the broad measures envisaged; and (iii) the programme's medium-term objective and the adjustment path towards it in structural terms.

### 4.2.1. The main goal of the programme's budgetary strategy

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 promotion of investments in the field of R&D, infrastructure and education including universities as well as social protection. Third, it envisages the implementation of structural reforms in the field of public administration; competition policy and the labour market in order to generate expenditure savings, which might be used for future tax rate cuts.[11] The first pillar of the strategy has remained unchanged from the previous programme. However with the new update, the achievement of the medium-term objective (MTO) has been postponed from 2008 to 2010 (see section 4.2.3 below). Compared with the previous programme, the new update broadly backloads the planned adjustment against a broadly more favourable macroeconomic scenario.

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[11] In its introductory chapter, the programme proposes using expenditure savings for future tax rate cuts (without giving a date). However, it seems that in its projections such tax rate cuts are not contained.

As Table 6 shows, the update foresees a decline in the general government deficit from 1.1% of GDP in 2006 turning into surplus of 0.4% in 2010. Substantial consolidation is foreseen only for the last two years of the programme period.

**Table 6: Composition of the budgetary adjustment**

| (% GDP) | 2005 (in bn €) | 2006 | 2007 | 2008 | 2009 | 2010 | Change: 2010-2006 |
|---|---|---|---|---|---|---|---|
| **Revenues** | 123.0 | 48.0 | 47.6 | 47.4 | 47.2 | 47.1 | **-0.8** |
| *of which:* | | | | | | | |
| - Taxes & social contributions | 110.9 | 43.2 | 43.0 | 42.9 | 42.7 | 42.6 | **-0.6** |
| - Capital taxes | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | **-0.1** |
| - Other (residual) | 12.0 | 4.6 | 4.6 | 4.5 | 4.5 | 4.5 | **-0.1** |
| **Expenditure** | 126.2 | 49.2 | 48.7 | 48.3 | 47.5 | 46.9 | **-2.4** |
| *of which:* | | | | | | | |
| - Primary expenditure | 118.4 | 46.2 | 45.8 | 45.4 | 44.7 | 44.2 | **-2.0** |
| *of which:* | | | | | | | |
| Collective Consumption | 17.2 | 6.9 | 6.9 | 7.1 | 6.7 | 6.6 | **-0.3** |
| Social transfers in kind | 27.2 | 11.0 | 10.9 | 10.9 | 10.9 | 10.9 | **-0.1** |
| Social transfers other than in kind | 45.6 | 18.3 | 18.1 | 18.0 | 17.8 | 17.6 | **-0.7** |
| Subsidies | 7.5 | 3.2 | 2.9 | 2.9 | 2.9 | 2.9 | **-0.3** |
| Gross fixed capital formation | 2.7 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | **0.0** |
| Other (residual) | 18.2 | 5.7 | 5.7 | 5.4 | 5.2 | 5.1 | **-0.6** |
| - Interest expenditure | 7.7 | 3.0 | 2.9 | 2.9 | 2.8 | 2.7 | **-0.3** |
| **General government balance (GGB)** | **-2.9** | **-1.1** | **-0.9** | **-0.7** | **-0.2** | **0.4** | **1.5** |
| **Primary balance** | **4.9** | **1.9** | **2.0** | **2.1** | **2.6** | **3.1** | **1.2** |
| One-offs[1] | 0.0 | 0.0 | -0.2 | -0.4 | -0.1 | 0.0 | 0.0 |
| **GGB excl. one-offs** | **-2.9** | **-1.1** | **-0.8** | **-0.4** | **-0.1** | **0.4** | **1.5** |

*Note:*
*Differences due to rounding.*
[1]*According to the programme update*
*Source:*
*Stability programme update; Commission services' calculations*

### 4.2.2. The composition of the budgetary adjustment

The programme states that the favourable economic climate would support budget consolidation through higher tax revenues and lower social security spending. Since revenue is nonetheless expected to fall by 0.8 percentage point (pp) of GDP in the period 2006-2010 as a result of relatively low tax elasticities, the planned consolidation relies on expenditure cuts with its ratio to GDP dropping by 2.4 pp. Among revenues, social contributions as percentage of GDP would decrease steadily over the programme period by a cumulated 0.4 pp. This is in line with the Commission services' forecast, taking into account that compensation of employees would lag behind nominal GDP growth over the programme period. In 2008, the social contribution rate to the public health system is planned to increase by 0.15 pp.

In the period 2006-2010, primary expenditures as a percentage of GDP are expected to fall by 2.0 pp, interest expenditure by 0.3 pp. Among primary expenditure, "Social transfers other than in kind" and "Other" are the categories where the envisaged expenditure reduction is the largest (-0.7 pp and -0.6 pp respectively).

Expenditures as percentage of GDP in the sub-category "collective consumption" are expected to decrease from 6.9% in 2006 to 6.6% in 2010 with an temporary increase in 2008 due to additional expenditure in military equipment. In the period from 2007 to 2009 the purchase of military aircraft to the amount of € 1.7 billion (around 0.6% of GDP) is planned. This figure includes other related costs, such as for procurement. In national accounts, military expenditure is recorded as intermediate consumption at time of delivery.[12] The purchase comprises 18 units, 4 of which are planned to be delivered in 2007, 12 in 2008 and the final 2 in 2009; the programme considers these to fall under the category "one-off and other temporary measures". The programme seems to expect counter-balancing effects in the collective consumption coming from further steps of the reform of public administration. Among this, the cutting of personnel and non-compulsory expenditures, (*Ermessensausgaben*, i.e. not based on contractual or legal obligations) is mentioned as the main saving measure in the update, although optional data on the public wage bill are not provided in the programme.

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**Box 1: The twin budget for 2007 and 2008**

The federal budget for 2007 was presented together with the budget for 2008 by the new Government on 29 March 2007. The adoption of the twin budget by the Parliament took place on 3 May 2007. The budget targets a general government deficit of 0.9% of GDP in 2007 and 0.7% in 2008. For 2007, public finances will furthermore benefit from actions taken well before this budget.

Regarding expenditures, the government plans increasing spending on R&D, education and social affairs. Spending on social affairs includes the increase in minimum pensions from 2007. At the same time, the 2004 pension reform, as well as economising on personnel and non-compulsory expenditure, are expected to lead to significant expenditure savings. Expenditure on military aircraft will burden the budget with 0.2% of GDP. In 2006 the government enacted several measures to lower the tax burden on SME by € 190 m, (around 0.1% of GDP) in 2007 (capital transfers in national accounts).

By mid 2007, an increase in fuel duties (+0.3 cent on diesel and +0.5 cent on petrol) will take effect.

Table: Main measures in the budget for 2007

| Revenue measures* | Expenditure measures** |
|---|---|
| o   Increase in fuel duties (0.1% of GDP) | o   Military Aircraft (-0.2% of GDP) <br> o   R&D, Education, Universities (-0.1% of GDP) <br> o   Social Protection (-0.1% of GDP) <br> o   SME package (-0.1% of GDP) |

 \* Estimated impact on general government revenues (+: additional revenues compared with 2006).
  \*\* Estimated impact on general government expenditure (+: expenditure savings compared with 2006)..
 *Sources*: Commission services and updated stability programme.

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[12]   Eurostat   Decision   on   Deficit   and   Debt,   9   March   2006,   available   at: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/DEFICIT_DEBT_2006/EN/DEFICIT_DEBT_2 006-EN.PDF

### *4.2.3. The medium-term objective (MTO) and the structural adjustment*

The update presents the medium-term objective (MTO) for the budgetary position to be a balanced budget in structural terms (i.e. cyclically-adjusted, net of one-off and other temporary measures), which it aims to nearly reach by 2009 and to surpass in 2010. The programme thus confirms the MTO as set in the Council opinion on the previous update of Novembers 2005, but the target date for its achievement has been pushed back from 2008 by two years.

The MTO lies within the range specified for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct. It adequately represents the debt ratio and average potential output growth in the long run. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1½ % of GDP for Austria), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit.

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**Box 2: The medium-term objective (MTO) for the budgetary position**

According to the Stability and Growth Pact, stability and convergence programmes must present a medium-term objective (MTO) for the budgetary position. The MTO is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances.

The MTO should fulfil a triple aim. First, it should provide a safety margin with respect to the 3% of GDP deficit limit. Second, it should ensure rapid progress towards sustainability. Third, taking into account the first two goals, it should allow room for budgetary manoeuvre, considering in particular the needs for public investment. The code of conduct further specifies that, as long as the methodology for incorporating implicit liabilities is not fully developed and agreed by the Council, the country-specific MTOs are set taking into account the current government debt ratio and potential growth (in a long-term perspective), while preserving a sufficient margin against breaching the 3% of GDP deficit reference value. Member States are free to set an MTO that is more demanding than strictly required by these provisions.

The MTO is defined in structural terms, i.e. it is adjusted for the cycle and one-off and other temporary measures are excluded. For countries belonging to the euro area or participating in the exchange-rate mechanism (ERM II), the MTO should be in a range between a deficit of 1% of GDP and balance or surplus (in structural terms).

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Table 7 shows the budgetary strategy in cyclically-adjusted and structural terms, allowing a comparison with the Commissions services' spring 2007 forecast: The structural balance resulting from Commission services' calculations on the basis of the programme according to the commonly agreed methodology, is planned to improve from a deficit of 0.9% of GDP in 2006 to a slight surplus of 0.2% in 2010. The consolidation effort is back-loaded, with the most significant improvement planned to take place in the last year (½ pp in 2010). Between 2006 and 2009, the fiscal stance is considered as broadly neutral as the structural balance is planned to improve by less than or equal to ½ pp of GDP per year and by only ¼ pp of GDP per year if the impact of a declining interest burden is taken into consideration.

This assessment takes into account one-offs as identified in the programme. According to the programme, the profile of the structural adjustment over the programme period would be influenced by the purchase of military equipment between 2007 and 2009, which the programme regards as deficit-increasing one-offs. However, in the view of the Commission services, this purchase does not meet the criteria for deficit-increasing one-off and temporary measures. Disregarding such one-offs (i.e. looking at the cyclically-adjusted rather than structural balance according to the programme), the adjustment effort over the programme period would appear to be even more heavily back-loaded, with no adjustment in 2007, a small effort in 2008 and a more sizeable one in both 2009 and 2010.

The different view on one-offs partly explains the differences between the structural balances according to the programme and to the Commission services' spring 2007 forecast. However, even abstracting from the treatment of military expenditure as one-offs, the structural adjustment envisaged in the update (as recalculated by Commission services) would be stronger compared with Commission services' spring forecast. This can be seen from comparing the projected cyclically-adjusted balances (which still include possible one-offs). This is due to the differences in the output gap as calculated in the Commission services forecast and the Commission services' recalculations based on the programme information (mentioned in Section 3.2). *Ceteris paribus*, lower potential growth would imply a higher cyclical component of a given deficit target.

**Table 7: Output gaps and cyclically-adjusted and structural balances**

| % of GDP | 2005 COM | 2005 SP[1] | 2006 COM | 2006 SP[1] | 2007 COM | 2007 SP[1] | 2008 COM | 2008 SP[1] | 2009 SP[1] | 2010 SP[1] | Change: 2010-2006 SP[1] |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Gen. gov't balance | -1.6 | - | -1.1 | -1.1 | -0.9 | -0.9 | -0.8 | -0.7 | -0.2 | 0.4 | 1.5 |
| One-offs[2] | 0.0 | - | 0.0 | 0.0 | 0.0 | -0.2 | 0.0 | -0.4 | -0.1 | 0.0 | n.a. |
| Output gap[3] | -1.1 | -1.1 | -0.2 | -0.3 | 0.5 | 0.1 | 0.8 | -0.1 | 0.1 | 0.3 | n.a. |
| CAB[4] | -1.1 | | -1.0 | -1.0 | -1.1 | -0.9 | -1.2 | -0.7 | -0.2 | 0.2 | 1.2 |
| *change in CAB* | -0.4 | | 0.0 | | -0.1 | 0.0 | -0.1 | 0.2 | 0.5 | 0.5 | n.a. |
| CAPB[4] | 1.8 | | 1.7 | 2.0 | 1.5 | 2.0 | 1.4 | 2.2 | 2.5 | 2.9 | 0.9 |
| Structural balance[5] | -1.1 | | -1.0 | -1.0 | -1.1 | -0.8 | -1.2 | -0.4 | -0.2 | 0.2 | 1.2 |
| *change in struct. bal.* | -0.4 | | 0.0 | | -0.1 | 0.2 | -0.1 | 0.4 | 0.2 | 0.4 | n.a. |
| Struct. prim. bal.[5] | 1.8 | | 1.7 | 2.0 | 1.5 | 2.1 | 1.4 | 2.5 | 2.6 | 2.9 | 0.9 |

Notes:

[1]Output gaps and cyclical adjustment according to the stability programme (SP) as recalculated by Commission services on the basis of the information in the programme.

[2]One-off and other temporary measures.

[3]In percent of potential GDP. See Table 2 above.

[4]CA(P)B = cyclically-adjusted (primary) balance.

[5]Structural (primary) balance = CA(P)B excluding one-offs and other temporary measures.

*Source*:

*Commission services' spring 2007 economic forecasts (COM); Commission services' calculations*

## 4.3. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2008,

Table 8 compares the detailed revenue and expenditure projections in the Commission services' spring 2007 forecast, which take into account the March 2007 twin budgets for 2007 and 2008 and are derived under a no-policy change scenario, with those in the updated programme.

As mentioned in Section 3.7.1 above, macroeconomic developments, also regarding composition, are broadly plausible. The Commission services' projection is slightly less "tax-rich" due to the relatively higher contribution from exports (see above). In addition, it is somewhat more cautious on indirect tax revenues, where the projected increase in the oil price could offset the additional revenue expected in the programme from the increase of the mineral oil tax rate in 2007. However, the differences between the Commission services forecast and the update are not very large.

Therefore, the risk assessment should focus on the expenditure side. The budgetary path projected in the update seems plausible for 2007 and 2008. It should be noted that the lower expenditure ratio projected by the Commission services as compared with the programme is almost exclusively the result of higher nominal GDP growth projected by the Commission services. In €-terms both projections are very similar. Therefore, the Commission services project the budgetary execution as tight as planned despite higher than projected GDP growth. Beyond the reach of the twin budget, i.e. in the outer years 2009-2010, the updated programme foresees the expenditure ratio to decline further by 1.4 percentage points. As Table 8 shows, this is distributed into the sub-categories of collective consumption (consolidation by 0.5 percentage points), monetary transfers (0.4 pp), "other" (0.3 pp) and interest (0.2 pp).

The development of collective consumption is driven by the purchase of military aeroplanes in 2007-2009. As the recording in national accounts is at the time of delivery, the expenditure on collective consumption would rise in particular in 2007 and 2008, with about 0.15 and 0.35 pp of GDP (each compared with the previous year). As in 2009 the expenditure on the aeroplanes drops to 0.1 % of GDP and in 2010 to zero, the phasing-out of such singular expenditure by 2010 might explain most of the decline in collective consumption spending between the years 2008 and 2010. Thus, netting out those singular purchases would result in a declining trend in collective consumption over the entire programme period. While such a trend has been noticeable since the late-1990s, it is uncertain whether this trend can be expected to continue unabated. In its overview of particular measures, the programme only foresees moderate reductions from "administrative reform" in the outer years.

The programme suggests further increases in educational spending, which would *ceteris paribus* also burden government consumption. On the other hand, social transfers on health care (individual consumption) would benefit from savings amounting to € 300 million (0.1% of GDP) until 2008, which were agreed within the framework of the health reform in 2005. For the outer period, the updated programme states that savings of € 100 million (less than 0.1% of GDP) were agreed on in the government programme of 11 January 2007.

The programme projects a reduction in monetary transfers by 0.7 percentage points of GDP between 2006 and 2010. The reduction in the expenditure ratio due to a reduction in social transfers would be, according to the programme, due to the improving labour market situation. Over the whole programme period, this would, according to the break-down provided in the programme, amount to 0.3 percentage points of GDP. However, the update also lists increased "social security" spending as part of the additional

spending programme by the new government ("Offensivprogramm"). Indeed, the Commission services' forecast also projects a reduction in monetary transfers (by 0.5 percentage points of GDP between 2006 and 2008), some of which is, however, due to growth projected higher than in the programme scenario. Overall, under the programme scenario, perhaps slightly more than half of the projected decline in monetary transfers as a percentage of GDP would be backed by policy developments explained in the programme.

The category "other expenditure" is a residual, but contains mostly current and capital transfers from government. From the additional information provided in the programme, it is not clear how the projected decline, especially in the outer years, would be achieved. The "Offensivprogramm" would even provide for an increase in this category, if the planned additional spending on R&D is given as investment grants. Moreover, more investment in infrastructure on road and rail is foreseen until 2010. If this was funded by transfers to the road infrastructure operator ASFINAG and the rail operator ÖBB, both of which are not part of general government, expenditure on "current transfers" would also rise. On the other hand, Austria conducted and committed to a series of debt cancellations to foreign states, which is recorded as capital expenditure in national accounts. These commitments might phase-out in the outer years of the programme. However, since none of these issues is diligently documented in the stability programme update, doubts must remain over the projected decrease as a percentage of GDP in this sub-category.

In a long-term perspective, Austria has quite a good track record in terms of avoiding unfunded expenditure overruns. In the last eight years, both expenditures and revenues in nominal terms were higher than planned in the budget laws, with on average, the extent of higher revenues exceeding higher-than expected expenditures. Thus, general government deficits usually turned out lower than foreseen in the updated programmes submitted in the past. However, as regards those years not covered by the budget, the track record is less spectacular. This is evidenced by the current update, which postpones the consolidation that was foreseen in the outer years of the previous programme of November 2005 once again to the outer years.

In sum, the budgetary projections seem plausible for 2007 and 2008. Beyond that, outcomes may be worse than targeted in the programme as there is a risk that measures necessary to underpin the envisaged expenditure restraint are not adopted or rigorously implemented, also in view of past experience.

## Table 8: Comparison of budgetary developments and projections

| (% of GDP) | 2005 | 2006 COM | 2006 SP | 2007 COM | 2007 SP | 2008 COM[1] | 2008 SP | 2009 SP | 2010 SP |
|---|---|---|---|---|---|---|---|---|---|
| **Revenues** | 48.2 | 48.0 | 48.0 | 47.4 | 47.6 | 47.1 | 47.4 | 47.2 | 47.1 |
| *of which:* | | | | | | | | | |
| - Taxes & social contributions | 27.3 | 43.2 | 43.2 | 42.7 | 43.0 | 42.4 | 42.9 | 42.7 | 42.6 |
| - Capital taxes | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| - Other (residual) | 21.1 | 4.8 | 4.8 | 4.8 | 4.8 | 4.8 | 4.7 | 4.5 | 4.5 |
| **Expenditure** | 49.8 | 49.2 | 49.2 | 48.4 | 48.7 | 48.0 | 48.3 | 47.5 | 46.9 |
| *of which:* | | | | | | | | | |
| - Primary expenditure | 46.9 | 46.5 | 46.2 | 45.8 | 45.8 | 45.4 | 45.4 | 44.7 | 44.2 |
| *of which:* | | | | | | | | | |
| Collective Consumption | 6.9 | 6.9 | 6.9 | 6.8 | 6.9 | 6.9 | 7.1 | 6.7 | 6.6 |
| Social transfers in kind | 11.2 | 11.2 | 11.0 | 10.9 | 10.9 | 10.8 | 10.9 | 10.9 | 10.9 |
| Social transfers other than in kind | 18.6 | 18.3 | 18.3 | 18.0 | 18.1 | 17.8 | 18.0 | 17.8 | 17.6 |
| Subsidies | 3.1 | 3.2 | 3.2 | 3.1 | 2.9 | 3.1 | 2.9 | 2.9 | 2.9 |
| Gross fixed capital formation | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.0 | 1.1 | 1.1 | 1.1 |
| Other (residual) | 6.0 | 5.8 | 5.7 | 5.9 | 5.7 | 5.8 | 5.4 | 5.2 | 5.1 |
| - Interest expenditure | 2.9 | 2.7 | 3.0 | 2.6 | 2.9 | 2.6 | 2.9 | 2.8 | 2.7 |
| **GGB** | -1.6 | -1.1 | -1.1 | -0.9 | -0.9 | -0.8 | -0.7 | -0.2 | 0.4 |
| **Primary balance[3]** | 1.3 | 1.6 | 1.9 | 1.8 | 2.0 | 1.7 | 2.1 | 2.6 | 3.1 |
| One-offs[2] | 0.0 | 0.0 | 0.0 | 0.0 | -0.2 | 0.0 | -0.4 | -0.1 | 0.0 |
| **GGB excl. one-offs** | -1.6 | -1.1 | -1.1 | -0.9 | -0.8 | -0.8 | -0.4 | -0.1 | 0.4 |

Notes:

Differences due to rounding.

[1] On a no-policy change basis.

[2] One-offs and other temporary measures.

[3] Data on the primary balance in the programme and in the Commission services' forecasts are not directly comparable because of a different treatment of FISIM. Data in the programme follow the definitions required by the code of conduct. To be comparable with data in the programme, Commission data on the primary balance need to be adjusted by around +0.2% of GDP.

*Source:*

*Commission services' spring 2007 economic forecast (COM); Stability programme update (SP); Commission services' calculations*


## Table 9: Assessment of tax projections

| | 2007 SP | 2007 COM | 2007 OECD[3] | 2008 SP | 2008 COM[1] | 2008 OECD[3] | 2009 SP | 2010 SP |
|---|---|---|---|---|---|---|---|---|
| Change in tax-to-GDP ratio (total taxes) | -0.3 | -0.6 | -0.1 | -0.1 | -0.3 | -0.1 | -0.2 | -0.1 |
| *Difference (SP – COM)* | 0.3 | | / | 0.2 | | / | / | / |
| *of which [2]:* | | | | | | | | |
| - *discretionary and elasticity component* | 0.2 | | / | 0.1 | | / | / | / |
| - *composition component* | 0.1 | | / | 0.1 | | / | / | / |
| *Difference (COM - OECD)* | / | -0.5 | | / | -0.3 | | / | / |
| *of which [2]:* | | | | | | | | |
| - *discretionary and elasticity component* | / | -0.6 | | / | -0.4 | | / | / |
| - *composition component* | / | 0.3 | | / | 0.1 | | / | / |
| p.m.: Elasticity to GDP | 0.9 | 0.7 | 1.0 | 0.9 | 0.8 | 1.0 | 0.9 | 1.0 |

Notes:

[1] On a no-policy change basis.

[2] The decomposition is explained in Annex 5.

[3] OECD ex-ante elasticity relative to GDP.

*Source:*

*Commission services' spring 2007 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)*

### 4.4. Assessment of the fiscal stance and budgetary strategy

The table below offers a summary assessment of the country's position relative to the budgetary requirements laid down in the Stability and Growth Pact. In order to highlight the role of the preceding analysis of the risks that are attached to the budgetary targets presented in the programme, this assessment is done in two stages: first, a preliminary assessment on the basis of the targets taken at face value is made (middle column) and, second, the final assessment that also takes into account risks (final column).

**Table 10: Overview of compliance with the Stability and Growth Pact**

| | **Based on programme**[3] (with targets taken at face value) | **Assessment** (taking into account risks to targets) |
|---|---|---|
| a. Safety margin against breaching 3% of GDP deficit limit[1] | throughout programme period | throughout programme period |
| b. Achievement of the MTO | by the end of the programme period (2010) but already broadly achieved in 2009 | possibly not within the programme period |
| c. Adjustment towards MTO in line with the Pact[2]? | is insufficient and should be strengthened | is insufficient and should be strengthened |

Notes:
[1]The risk of breaching the 3% of GDP deficit threshold with normal cyclical fluctuations, i.e. the existence of a safety margin, is assessed by comparing the cyclically-adjusted balance with the above mentioned minimum benchmark (estimated as a deficit of around 1½% of GDP for Austria). These benchmarks represent estimates and as such need to be interpreted with caution.
[2]The Stability and Growth Pact requires Member States to make progress towards their MTO (for countries in the euro area or in ERM II, this has been quantified as an annual improvement in the structural balance of at least 0.5% of GDP as a benchmark). In addition, the structural adjustment should be higher in good times, whereas it may be more limited in bad times.
[3]Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.

*Source:*
*Commission services*

Taking into account risks to the projections, the budgetary position suggests a sufficient safety margin against breaching the 3% of GDP threshold for the deficit with normal cyclical fluctuations throughout the programme period.

Given the projected structural balance of -0.2%[13] of GDP in 2009 and +0.2% of GDP in 2010, the MTO (a balanced position in structural terms) will broadly be achieved by 2009 according to the programme. In view of the above risk assessment, however, especially for the outer years, the MTO might not be reached by the end of the programme period. In Chapter 3.3 it was pointed out that the update projects potential growth higher than the Commission services' spring forecast. If potential growth fell short of the update's expectations, the structural balance would widen.

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[13] Commission services calculation on the basis of the information in the programme, taking account the deficit increasing One-offs.

The programme projects a back-loaded structural adjustment of 1¼ percentage point of GDP in cumulative terms between 2006 and 2010. On average, this implies an adjustment of ¼ percentage points per year. Overall, the pace of the adjustment towards the MTO implied by the programme is insufficient and should be strengthened; this conclusion is reinforced when considering that there are risks to the achievement of the budgetary targets in the outer years. Especially in 2007 and 2008, given that the output gap is projected to be positive and the economy in "good times", the structural adjustment should be much stronger than proposed in the update. The structural deficit amounts to around 1% of GDP in 2006. Thus, if the structural adjustment were in line with the 0.5% of GDP benchmark improvement in the Pact (let alone a bit stronger in view of the good times), the MTO could still be reached by 2008 as envisaged in the previous update of the programme.

**Figure 8: Changes in the tax-to-GDP ratio:**
**actual/projected changes vs. changes implied by OECD elasticity**
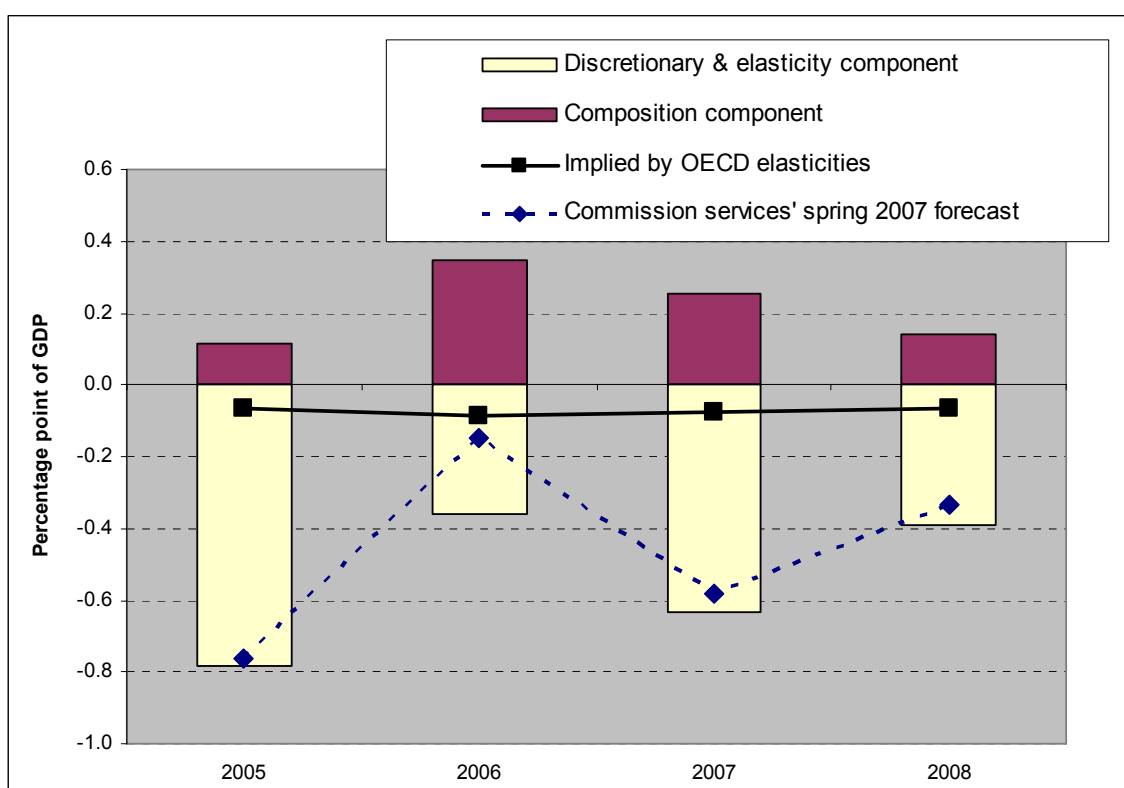


Note:
The dashed line displays the change in the tax ratio in the Commission services' spring 2007 forecast, for 2008, on a no-policy-change basis. The solid line shows the change in the tax ratio implied by the ex-ante OECD elasticity with respect to GDP. The difference between the two is explained by the bars. The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags, variations of taxable income that do not necessarily move in line with GDP e.g. capital gains. Both components may not add up to the total difference because of a residual component, which is generally small. The decomposition is explained in detail in Annex 5.

*Source:*
*Commission services*

## 5.    GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

Government debt is the result of the financing needs of government over the years. It corresponds primarily to an accumulation of deficits, although the build-up of financial assets and other adjustments may also play a role.[14] The reform of the Stability and Growth Pact has raised attention to the crucial importance of government debt and of sustainability in fiscal surveillance.

This section is in two parts: a first part describes recent developments and the medium-term prospects for government gross debt; it describes the stability programmes targets, compares them with the Commission services' forecasts and assesses the associated risks. A second part looks into the government debt from a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

### 5.1.    Recent debt developments and medium-term prospects

#### 5.1.1.    Debt projections in the programme

Given the lower than expected budget deficit and the higher nominal GDP, the general government debt ratio decreased to 62.2% in 2006 and turned out to be lower than assumed in the previous update (63.1%). Over the last number of years, the reduction in the debt ratio has been the result of primary surpluses, which more than offset the snowball effect – that is, the combined effect of interest expenditure and ratio-decreasing impact on nominal GDP growth. The reduction in the debt ratio has been tempered by positive stock-flow adjustments which reflect mainly accumulation of financial assets.

The current update expects the debt ratio to fall further below the 60% reference value in 2008, which is also in line with the previous update.

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[14]    On the factors other than the deficit which explain the evolution of the government debt, see "The dynamics of government debt: decomposing the stock-flow adjustment", chapter II.2.2 of *Public Finances in EMU 2005*, European Economy, N°3/2005.

# Figure 9: Debt projections in successive stability programmes (% of GDP)
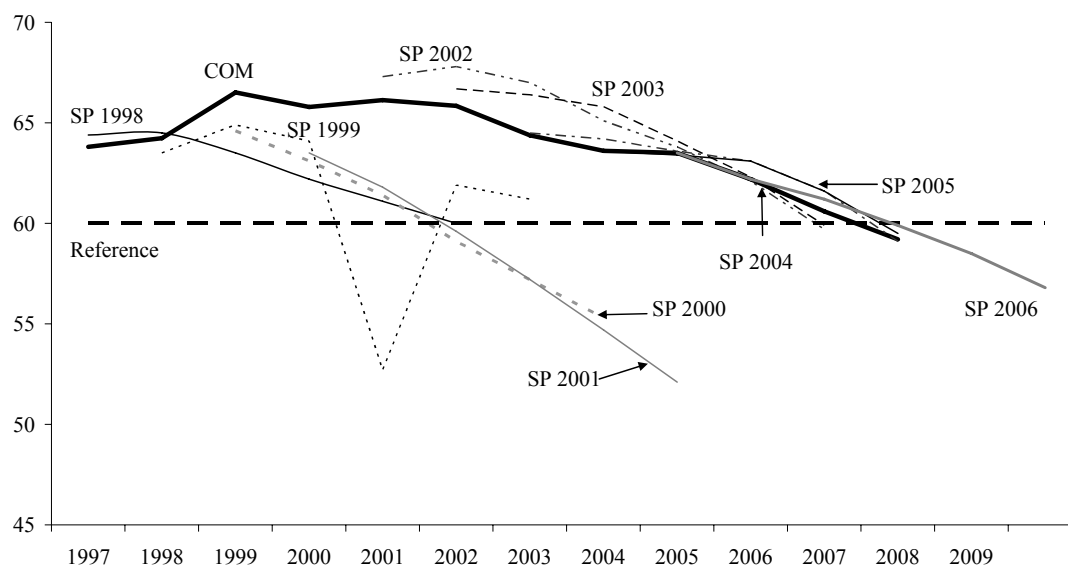


*Source : Commission services' spring 2007  forecast (COM) and successive stability programmes*

# Table 11: Debt dynamics

| (% of GDP) | average 2000-05 | 2006 | 2007 | | 2008 | | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| | | | COM | SP | COM | SP | SP | SP |
| **Gross debt ratio**[1] | **63.9** | **62.2** | **60.6** | **61.2** | **59.2** | **59.9** | **58.5** | **56.8** |
| Change in the ratio | -0.5 | -1.3 | -1.6 | -1.0 | -1.4 | -1.3 | -1.4 | -1.7 |
| *Contributions* [2] *:* | | | | | | | | |
| Primary balance | -2.2 | -1.6 | -1.8 | -2.0 | -1.7 | -2.2 | -2.6 | -3.1 |
| "Snow-ball" effect | 1.0 | -0.1 | -0.2 | 0.3 | 0.1 | 0.5 | 0.6 | 0.5 |
| *Of which:* | | | | | | | | |
| Interest expenditure[4] | 3.2 | 2.7 | 2.6 | 2.9 | 2.6 | 2.9 | 2.8 | 2.7 |
| *Growth effect* | | | | | | | | |
| *(real GDP)* | -1.1 | -1.9 | -1.7 | -1.6 | -1.4 | -1.4 | -1.4 | -1.5 |
| *Inflation* | | | | | | | | |
| *(GDP deflator)* | -1.0 | -0.9 | -1.1 | -1.0 | -1.0 | -1.0 | -0.8 | -0.8 |
| Stock-flow adjustment | 0.7 | 0.4 | 0.3 | 0.7 | 0.3 | 0.4 | 0.6 | 0.9 |
| *Of which:* | | | | | | | | |
| Cash/accruals diff. | 0.1 | 0.5 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Acc. financial assets | 0.9 | 0.4 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| *Privatisation* | -0.3 | 0.0 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Val. effect & residual | -0.4 | -0.5 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |

Notes:

[1]End of period.

[2]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 (in the table, the latter is decomposed into the growth effect, capturing real GDP growth, and the inflation effect, measured by the GDP deflator). The term in parentheses represents the "snow-ball" effect. The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

[4]Data on the primary balance in the programme and in the Commission services' forecasts are not directly comparable because of a different treatment of FISIM. Data in the programme follow the definitions required by the code of conduct. To be comparable with the programme data, expenditure on FISIM of 0.1-0.2% of GDP would have to be added to the Commission figure.

*Source :*

*Stability programme update (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations*

### 5.1.2. Assessment

Both the Commissions services' spring 2007 forecast and the programme foresee a decline in the debt ratio from 2006 onwards, dropping below the 60% reference value in 2008. The slightly stronger downward trend seen by the Commission comes from the higher growth scenario in 2007 and 2008. For the outer years, the programme expects a further reduction to 56.6% of GDP until the end of the programme period. Table 11 shows that the progressive increase in the primary surplus contributes to the reduction in the debt ratio and over-compensates the "snow-ball" effect.

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**Box 3: The rolling debt reduction benchmark**

The debt ratio has been exceeding the 60% of GDP reference value since 1994. A tentative assessment of the pace of debt reduction over a medium-term horizon is presented in the accompanying graph. It shows historical data, the Commission services' spring 2007 forecasts until 2008 (which are on a no-policy change scenario) and the multi-annual debt projections in the update and compares them with the paths obtained by applying an illustrative "rolling debt reduction benchmark" (*). The benchmark reflects the idea that a minimum debt reduction should be ensured not year after year but over a medium-term horizon (five years in the graph). For instance, the debt projection for 2007 is compared with the value obtained for the same year by applying the formula starting in 2002. Debt level projections in the programme exceeding those obtained by applying the benchmark are taken as an indicator of a slow reduction in the debt ratio.

The graph clearly shows that the planned reduction of the debt ratio in the update is more than implied by the five-year rolling debt reduction benchmark over the last number of years and throughout the programme period.



**Austria: rolling five-year debt benchmark**
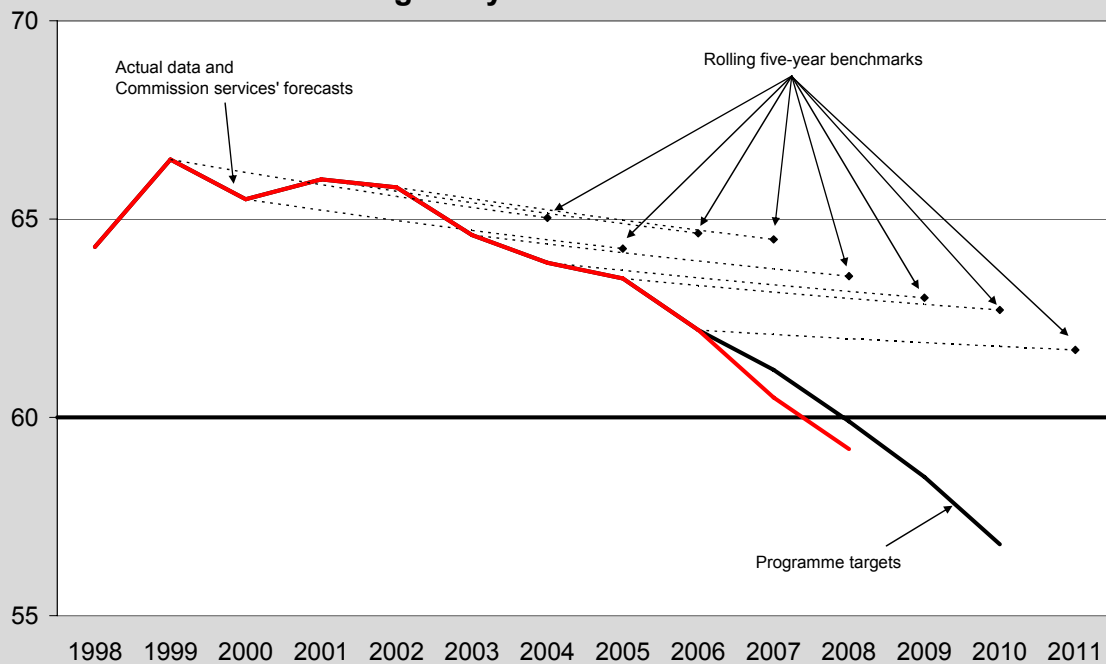
*Source : Stability programme and Commission services*

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(*) The rolling debt reduction benchmark for successive five-year periods is defined as a reduction in the difference between the debt ratio and the 60% of GDP reference value of 5 percent per year:

$$\left(\frac{D_t}{Y_t}\right)_{benchmark} = \left(\frac{D_t}{Y_t}\right)_{benchmark} - 5\% \times \left[\left(\frac{D_t}{Y_t}\right)_{benchmark} - 60\right]$$, where $t$ is a time subscript and $D$ and $Y$ are the stock of government debt and nominal GDP, respectively. In the first year of the five-year period, the debt ratio in the previous year is the actual debt ratio. Given the usual approximation of the change in the debt ratio $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{DEF_t}{Y_t} - \frac{y_t}{1+y_t} \times \frac{D_{t-1}}{Y_{t-1}} \cong \frac{DEF_t}{Y_t} - y_t \times \frac{D_{t-1}}{Y_{t-1}}$ and assuming that the stock-flow adjustment is zero, it is easy to show that the rolling debt reduction benchmark describes the path for convergence of the debt ratio towards 60% of GDP which would take place with the deficit at 3% of GDP and nominal GDP growth at 5%. In other words, the 5 percent per year benchmark is the value that makes consistent a continuous respect of the 3% of GDP deficit threshold and an asymptotic respect of the 60% of GDP debt reference value.

## 5.2. Long-term debt projections and the sustainability of public finances

The issue of long-term sustainability is a multi-faceted one. It involves avoiding imposing an excessive burden on future generations and ensuring the country's capacity to appropriately adjust budgetary policy in the medium and long run.[15]

Debt sustainability is derived from the government's *intertemporal budget constraint*. It imposes that current total liabilities of the government, i.e. the current public debt and the discounted value of future expenditure including the budgetary impact of ageing populations, should be covered by the discounted value of future government revenue. If current policies ensure that the intertemporal budget constraint is fulfilled, current policies are sustainable.

The approach adopted by the Commission services and the Ageing Working Group of the Economic Policy Committee (EPC) is to project the debt, and to calculate the associated sustainability indicators (see Box 4), on the basis of two different scenarios. The first scenario assumes that the structural primary balance will remain unchanged from 2006 through 2010, the final year of the stability programme; it is called the "2006 scenario". Debt and primary balance projections in this scenario start in 2007. The second scenario assumes that the macroeconomic and budgetary plans until 2010 provided in the stability programme will be fully respected. This is the "programme scenario". Debt and primary balance projections in this scenario start in 2011. In addition to this quantitative analysis, other relevant factors are taken into account which allows to better qualify the assessment with regard to where the main risks are likely to stem from and to reach an overall assessment.

### 5.2.1. *Sustainability indicators and long-term debt projections*

Table 12 shows the evolution of government spending on pensions, healthcare, long-term care for the elderly, education and unemployment benefits according to the EPC's projections[16]. Non age-related primary expenditure and revenue is assumed to remain constant as a share of GDP.

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[15] For a detailed analysis of long-term sustainability issues, see "The Long Term Sustainability of Public Finances – A report by the Commission services", European Economy n°4/2006, published in October 2006.

[16] These assumptions cover labour productivity growth, real GDP growth, participation rates, unemployment rate, demographic developments, government spending in pensions, healthcare, long-term care for the elderly, education and unemployment benefits. See Economic Policy Committee and European Commission (DG ECFIN) (2006), "The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health-care, long-term care, education and unemployment transfers (2004-2050)", European Economy, Special Report No 1.

**Table 12: Long-term age-related expenditure: main projections**

| (% of GDP) | 2005 | 2010 | 2020 | 2030 | 2040 | 2050 | Changes |
|---|---|---|---|---|---|---|---|
| **Total age-related spending*** | 25.2 | 24.2 | 24.2 | 26.0 | 26.1 | 25.3 | 0.2 |
| Pensions | 13.4 | 12.8 | 12.8 | 14.0 | 13.4 | 12.2 | -1.2 |
| Healthcare | 5.3 | 5.5 | 5.9 | 6.3 | 6.7 | 6.8 | 1.6 |
| Long-term care | 0.6 | 0.7 | 0.8 | 1.0 | 1.2 | 1.5 | 0.9 |
| Education | 5.1 | 4.6 | 4.1 | 4.2 | 4.2 | 4.1 | -1.0 |
| Unemployment benefits | 0.8 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | -0.1 |
| *Source: Economic Policy Committee and Commission services.* | | | | | | | |

The projected increase in age-related spending in Austria is below the average of the EU; rising by 0.2 p.p. of GDP between 2004 and 2050. Public expenditure on pensions is projected to decrease in Austria, largely explained by the comprehensive pension reform enacted in 2004. The increase in expenditure on health-care is projected to be 1.6 p.p. of GDP, same as in the EU. For long-term care, an increase of 0.9 p.p. of GDP is projected, slightly above the EU average.[17]

Based on the long-term budgetary projections, sustainability indicators can be calculated.

**Table 13: Sustainability indicators and the required primary balance**

| | 2006 scenario | | | Programme scenario | | |
|---|---|---|---|---|---|---|
| | S1 | S2 | RPB | S1 | S2 | RPB |
| Value | -0.2 | -0.1 | 2.3 | -1.3 | -1.1 | 2.2 |
| *of which:* | | | | | | |
| Initial budgetary position | -1.2 | -1.1 | - | -2.2 | -2.2 | - |
| Debt requirement in 2050 | 0.0 | - | - | -0.1 | - | - |
| Future changes in budgetary position | 1.0 | 1.1 | - | 1.0 | 1.1 | - |
| *Source: Commission services.* | | | | | | |

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[17]  The stability programme projects the age-related expenditure ratio to rise by 0.2% points of GDP between 2005 and 2050, of which expenditure with pension is projected to decrease by 1 p.p. of GDP, as in the common projections in Table 12. However, the pension projection in the programme includes expenditure by the pension insurance that was not considered by the Economic Policy Committee (e.g. on administration), which increases the *level* of total public pension expenditure compared with the common projections throughout the projection period. The projection provided in this assessment follows the definitions by the Economic Policy Committee.

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## Box 4 – Sustainability indicators*

- The **sustainability gap S1** shows the permanent budgetary adjustment (often presented as an increase in the tax burden**) required to reach a debt ratio in 2050 of 60% of GDP.
- The **sustainability gap S2**, shows the permanent budgetary adjustment that guarantees the respect of the intertemporal budget constraint of the government. In order to estimate S2, the revenue and expenditure ratios (age-related and non age-related) after 2050 are assumed to remain constant at the 2050 level.
- The sustainability indicators can be decomposed into the***: (i) **initial budgetary position (IBP)**; and, (ii) **long-term change in the budgetary position (LTC)**;
- In addition, the **required primary balance (RPB)** can be derived from the S2 indicator. It measures the average primary balance over the first five years after the programme horizon (i.e. 2011-2015) that results from a permanent budgetary adjustment carried out to comply fully with the S2 indicator.

**Summarizing the sustainability indicators**

| | Impact of | | |
|---|---|---|---|
| | **Initial budgetary position** | | **Long-term changes in the primary balance** |
| **S1***= | Gap to the debt-stabilizing primary balance | + | Additional adjustment required to finance the increase in public expenditure *up to 2050* |
| **S2=** | Gap to the debt-stabilizing primary balance | + | Additional adjustment required to finance the increase in public expenditure *over an infinite horizon* |

\* For a complete description of the sustainability indicators, see Annex I of the "The Long Term Sustainability of Public Finances – A report by the Commission services", European Economy n°4/2006, published in October 2006.

\*\* Although the sustainability gap indicators (S1, S2) are usually defined as differences between revenue ratios, this does not mean that countries are asked to increase taxes to reach sustainability. There are several ways to ensure sustainability and governments typically choose a combination of budget consolidation over the medium term (either through expenditure reduction and/or tax hikes) and the implementation of structural reforms aiming at curbing long-term public spending (e.g. pension reforms).

\*\*\*Moreover, in the case of S1, the decomposition also separates the impact of the debt position (60% of GDP in 2050); the debt requirement in 2050 (DR). In particular, if the current debt/GDP ratio is below 60% of GDP debt is allowed to rise and this component reduces the sustainability gap as measured by the S1 indicator, and vice versa.

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Table 13 shows the sustainability indicators for the two scenarios. In the "2006 scenario", the sustainability gap (S1) that assures reaching the debt ratio of 60% of GDP by 2050 would be -0.2% of GDP. The sustainability gap (S2) which satisfies the intertemporal budget constraint would be 0.1% of GDP. Compared with the results of the Commission's Sustainability Report, the sustainability gaps are slightly smaller in the present assessment, by about 0.4 pp of GDP. This is mainly due to a higher estimated structural primary balance in 2006 (at 2.1% of GDP) compared with the structural primary balance in 2005 estimated in spring 2006 (at 1.7% of GDP) that was used in the Sustainability Report.

The initial budgetary position with a structural primary balance of 2.1% of GDP contributes to the reduction of gross debt. Moreover, the programme plans a strengthening of the structural budgetary balance by 1.3% points of GDP between 2006 and 2010, which would imply a reduction in risks to long-term sustainability of public finances reflected in lower sustainability gaps ("programme scenario") of some one p.p. of GDP , so that both S1 and S2 would be negative. According to both sustainability gaps, the long-term budgetary impact of ageing is limited in particular thanks to the enacted pension reforms.

The required primary balance (RPB) is around 2 ¼% of GDP, close to the structural primary balance in 2006 and lower than the one at the end of the programme period (3.1% of GDP in 2010).

Another way to look at the prospects for long-term public finance sustainability is to project the debt/GDP ratio over the long-term using the same assumptions as for the calculations of S1 and S2. The long-term projections for government debt under the two scenarios are shown in Figure 10.

The gross debt ratio is currently above the 60% of GDP reference value, estimated in the programme at 62.2% of GDP in 2006. According to the "2006 scenario", the debt ratio is projected to decrease up to the mid-2020s and thereafter stabilize at around 45% of GDP over the rest of the projection period. In the "programme scenario", the debt dynamics would be more favourable than in the 2006 scenario thanks to the consolidation of public finances over the programme period.[18]

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[18] It should be recalled, however, that being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

**Figure 10: Long-term projections for the government debt ratio**

**Debt projections**
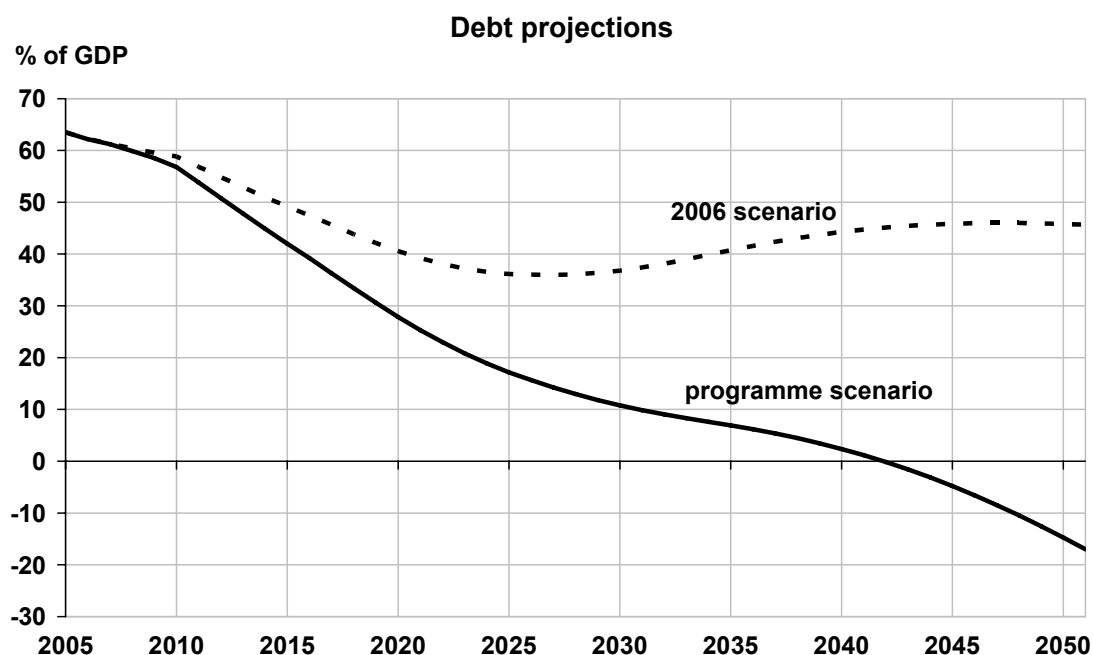


Source: Commission's services
Note: The government debt ratio is usually compiled in gross terms, that is assets are not netted out from government liabilities. Therefore, the gross debt can never be negative. In this chart, the negative values for the debt ratio should be understood as accumulation of financial assets. This issue has no implications on the conclusions drawn from the sustainability assessment.

### 5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant issues are taken into account, which in addition allows to better qualifying the assessment with regard to where the main risks are likely to stem from.

First, the benefit ratio (that is, the ratio of the average pension and the average wage in the economy) in Austria is projected to decrease relatively markedly, by almost 30%, in the period to 2050. Employment rates of older workers are currently lower in Austria (30%) than on average in the EU (40%) but are expected to increase more than on average in the EU up to 2050 to reach 58%, very close to the EU average of 59%. A greater increase in the employment rate of older workers than assumed in the projections would mean that the benefit ratio would decrease less markedly, as it would foster GDP growth and ensure that workers can accumulate more pension entitlements.

Second, Austria's current level of debt is slightly higher than 60% of GDP. A reduction in the debt ratio to below the reference value, which the update envisages to achieve in 2008, would strengthen the resilience of public finances to adverse shocks and reduce the risks to public finance sustainability.

### 5.2.3. Assessment

The long-term budgetary impact of ageing in Austria is well below the EU average, with pension expenditure projected to decrease as a share of GDP over the long-term, as a consequence of the significant expenditure containment expected from the 2004 pension reform. Overall, Austria appears to be at low risk with regard to the sustainability of public finances.

## 6. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES

The reform of public administration (covering administrative reforms and the reduction of staff levels) contributed markedly to the past consolidation effort of the general government. The reduction in the number of federal civil servants is envisaged to be continued over the programme period through limiting replacement in the public sector. The programme mentions further the budgetary impact of extending already ongoing administrative reforms by additional projects like the extension of "eGovernment" and the reduction of administrative costs of enterprises due to federal legislation.

In terms of financing the health sector, the rate of social contributions will be raised by 0.15 percentage points in 2008. Additional to the planned savings of € 300 million in 2007 and 2008 agreed already in the 2005 health reform, the programme foresees only limited savings amounting to less than 0.1% of GDP until 2010. Unfortunately, these savings on the expenditure side are not specified further.

**Figure 11: The evolution of government primary expenditure (functional classification) (% of total expenditure)**
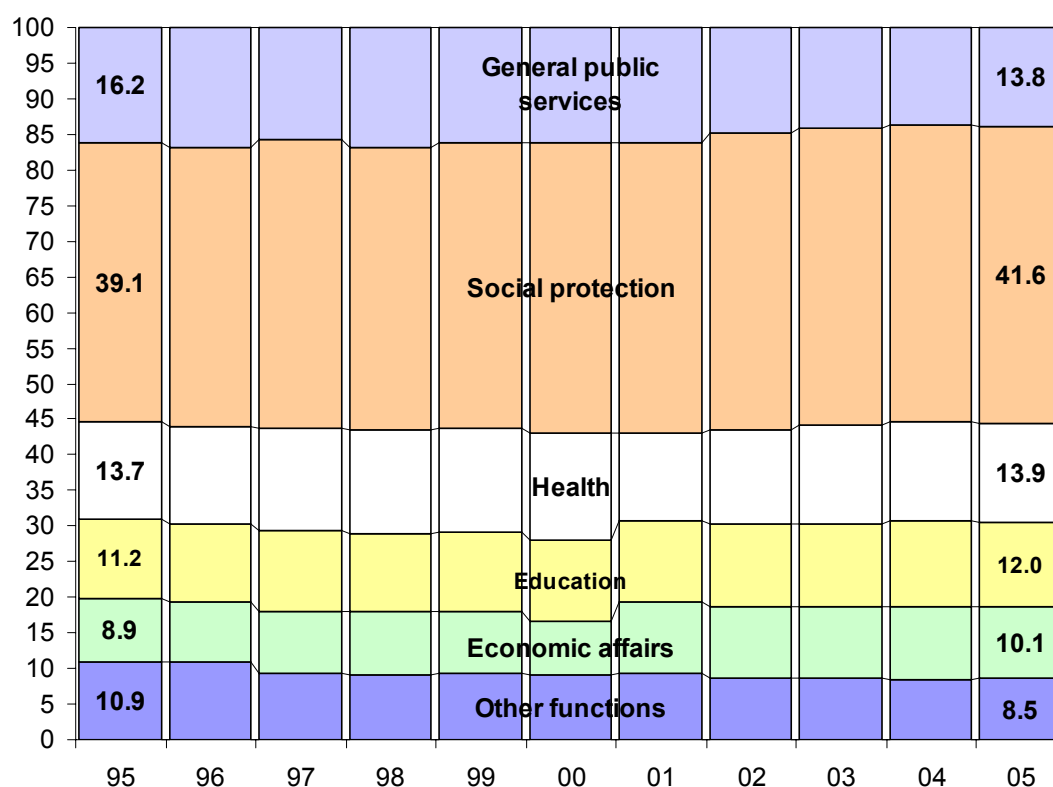


Note: "Other functions" include general services, defence, environment, culture, public order and housing.
*Source : Commission services*

The update refers to the reform of the budgetary law (already briefly mentioned in Section 2.5) as currently "work in progress", however without target date. It includes the introduction of a medium term budgetary framework with the implementation of binding expenditure ceilings as a central element. The reform was already envisaged in the

update of November 2005 to be introduced as of January 2007 and is supposed to lead to considerable budgetary savings.

As already briefly mentioned in Section 2.4, the composition of public expenditure changed in the course of the last 10 years with a relative increase in social affairs and health and education expenditures as shown in Figure 11, which shows the evolution of government primary expenditure (in functional classification) as a share of total expenditure since 1995. Total government expenditure fell from 56.0% of GDP in 1995 to 49.9% in 2005. Social protection contributed slightly to this by falling from 21.9% of GDP to 20.8% over this time period, which might reflect that the employment rate has risen by about 2 percentage points to almost 70% in 2005. However, as can also be seen from Figure 11, the reduction of spending on general public services carried the greatest weight in the reduction of the expenditure share in GDP. As Figure 12 shows, personnel cost have been considerably cut back. Between 1995 and 2003, public employment (including defence) fell by about 10% in cumulative terms, and (after a statistical break in the series) again by about 2% in 2005. This may reflect administrative reforms but also a general trend (in many EU countries) to open up parts of the public sector to competition through the privatisation of public monopolies. Shifting boundaries of the public sector might also partly be behind the decline in the investment share in total expenditure.

**Figure 12: The evolution of government expenditure (economical classification) (% of total expenditure)**
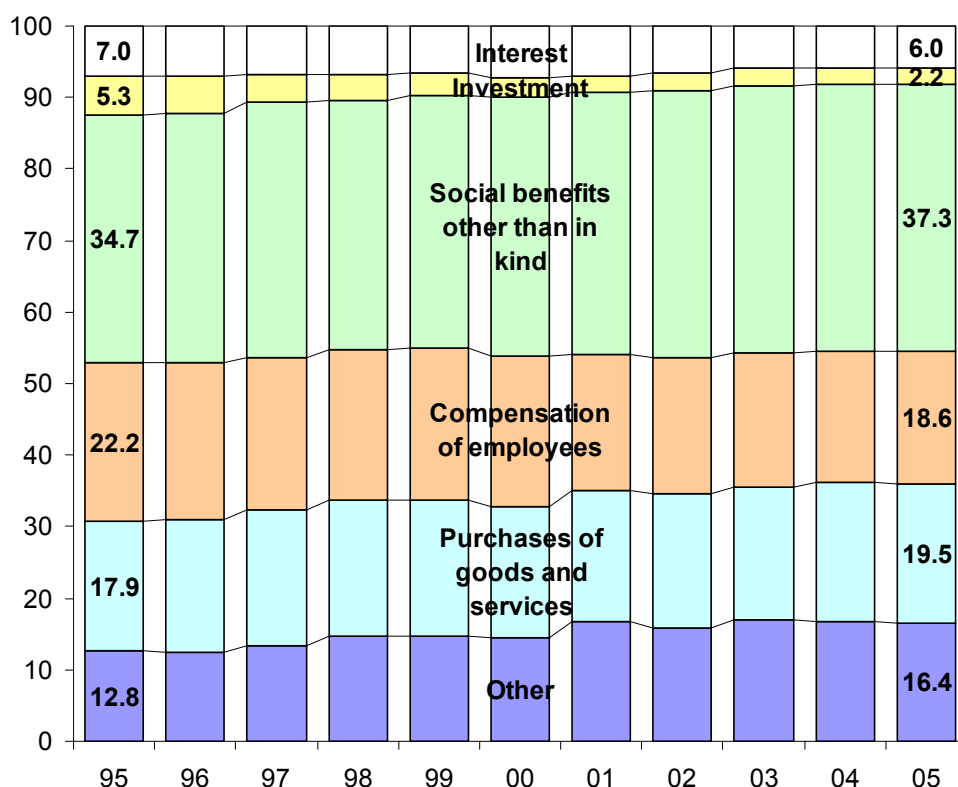


Note: "Other" includes subsidies and other current and capital transfers.

*Source*: Commission services

51

## 7. CONSISTENCY WITH THE NATIONAL REFORM PROGRAMME AND WITH THE BROAD ECONOMIC POLICY GUIDELINES

The stability programme contains a qualitative assessment of the overall impact of the September 2006 implementation report of the National Reform Programme within the medium-term fiscal strategy. In addition, it provides some information on the direct budgetary costs or savings of the main reforms envisaged in the National Reform Programme and the public finance implications of the actions outlined in the National Reform Programme are broadly consistent with its budgetary projections.. The measures in the area of public finances envisaged in the stability programme seem consistent with those foreseen in the National Reform Programme. In particular, expected savings from administrative reform and the reinforcement of spending on R&D are put forward in both programmes.

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**Box 5: The Commission assessment of the implementation report of the National Reform Programme**

The implementation report of the National Reform Programme of Austria, provided in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 25 September 2006. The Commission's assessment of this report, which was adopted on 12 December 2006 as part of its Annual Progress Report, can be summarised as follows.

The Austrian 2005-2008 National Reform Programme (NRP) identified seven strategic priority areas: public finance sustainability, R&D and innovation, infrastructure, international competitiveness, the environment, labour market, and education and training. The Commission agreed with these priority areas but, in its 2006 Annual Progress Report (APR), also considered that further attention should be given to competition in services, the low employment rate of older workers and vocational training of adults.

Austria is making good progress in the implementation of its National Reform Programme, especially in the micro-economic area, where a substantial range of measures has been implemented across the board except on competition in services. Macro-economic stability is strong, though additional impetus will be necessary to continue addressing risks to the long-term sustainability of public finances. Progress has also been generally good on employment policy, although more needs to be done in some areas.

The policy areas in the Austrian National Reform Programme where weaknesses need to be tackled with the highest priority are increasing labour supply from older workers and improving the skills of disadvantaged young people. Against this background Austria is recommended to improve incentives for older workers to continue working, notably by implementing a comprehensive lifelong learning strategy with a particular focus on job-related training and reforming tax benefits systems; and enhance the skills and qualifications of vulnerable youth. In addition, it will be important for Austria over the period of the National Reform Programme to focus on: (i) increasing competition in services; and (iii) strengthening the entrepreneurial culture; (iii) identifying further emission reduction policies and measures and (iv) tackling the gender segregation of the labour market, including by improving the availability of childcare.

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The table below provides an overview of whether the strategy and policy measures in the programme are consistent with the broad economic policy guidelines in the area of public finances, which are included in the integrated guidelines for the period 2005-2008. The assessment of guideline 1 corresponds to the evaluation in Section 4.4 above, whereas that of the pace of debt reduction in guideline 2 (relevant for high-debt countries only) is

covered in Section 5.1.2 above. Information on the different elements covered by the remaining guidelines in the table can be found in Sections 5.2 and 6.

Overall, the budgetary strategy in the stability programme is partly consistent with the broad economic policy guidelines.

**Table 14: Consistency with the broad economic policy guidelines**

| Broad economic policy guidelines | Yes | Steps in right direction | No | Not applicable |
|---|---|---|---|---|
| *1. To secure economic stability* | | | | |
| − Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it[1]. | | X | | |
| − Member States should avoid pro-cyclical fiscal policies[2]. | | | | |
| − Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits[3]. | | | | X |
| − Member States posting current account deficits that risk being unsustainable should work towards (…), where appropriate, contributing to their correction via fiscal policies. | | | | X |
| *2. To safeguard economic and fiscal sustainability*<br>In view of the projected costs of ageing populations, | | | | |
| − Member States should undertake a satisfactory pace of government debt reduction to strengthen public finances. | X | | | |
| − Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (…) | | X | | |
| *3. To promote a growth- and employment-orientated and efficient allocation of resources* | | | | |
| Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages. | | X | | |

Notes:

[1]As further specified in the Stability and Growth Pact and the code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States.

[2]As further specified in the Stability and Growth Pact and the code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in "good times".

[3]As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.

*Source*:
*Commission services*

\* \* \*

**Annex 1: Glossary**

**Automatic stabilisers** Various features of the tax and spending regime which tend to have a dampening effect on economic fluctuations without requiring a discretionary intervention of the fiscal authorities. As a result, the budget balance in percent of GDP tends to improve in years of high growth and deteriorate during economic slowdowns. See also *cyclically-adjusted balance, structural balance* and *minimum benchmark*.

**Broad economic policy guidelines (BEPGs)** Guidelines for the economic and budgetary policies of the Member States. Together with the Employment Guidelines, they form the Integrated Guidelines, prepared by the Commission and adopted by the Council of Ministers responsible for Economic and Financial Affairs (ECOFIN). See also *Lisbon strategy*.

**Budget balance** The balance between total public revenue and expenditure (according to *ESA95*); with a positive balance indicating a surplus (also know as *government net lending*) and a negative balance indicating a deficit (also known as *government net borrowing*). For the monitoring of Member States' budgetary positions, the EU uses *general government* aggregates. See also *cyclically-adjusted balance, primary balance, structural balance* and *reference values*.

**Budget constraint** A basic condition applying to the public finances, according to which total public expenditure in any one year must be financed by taxation, borrowing or changes in the monetary base; the latter is prohibited in the EU. See also *stock-flow adjustment* and *long-term sustainability*.

**Budgetary sensitivity** The variation in the *budget balance* brought about by a change in the *output gap*. In the EU, it is estimated to be 0.5 on average, i.e. for any percentage point of GDP below or above potential, the budget-balance-to-GDP ratio deteriorates or improves by half a percentage point. The size of the budgetary sensitivity essentially reflects (i) the revenue and expenditure elasticities of the budget and (ii) the size of discretionary government expenditure. See also *cyclically-adjusted balance, structural balance* and *tax elasticity*.

**Code of conduct** Policy document adopted by the Economic and Financial Committee (an advisory committee gathering high-level officials from national governments, national central banks, the European Central Bank and the European Commission which prepares the meetings of the Council of Ministers responsible for Economic and Financial Affairs (ECOFIN)) and endorsed by the ECOFIN Council in October 2005, containing specifications on the implementation of the *Stability and Growth Pact* and guidelines on the format and content of *stability programmes* and *convergence programmes*.

**Contingent liabilities** A possible government obligation to pay, the existence of which will be confirmed by the occurrence of one or more uncertain events in the future not wholly under the control of the government. For instance, government guarantees on debt issued by private or public companies are contingent liabilities since the government obligation to pay depends on the non-ability of the original debtor to honour its obligations. See also *implicit liabilities*.

**Convergence programme** Medium-term budgetary strategy presented by each Member State that has not yet adopted the euro; updated annually, according to the provisions of the *Stability and Growth Pact*. See also *stability programme, code of conduct* and *medium-term objective*.

**Cyclically-adjusted balance** The *budget balance* adjusted for its cyclical component (which captures the part of public revenue and expenditure that is linked to the *output gap*), i.e. the budget balance that would prevail if GDP were at its potential level. See also *structural balance, budgetary sensitivity* and *output gap*.

**Cyclically-adjusted primary balance** The *cyclically-adjusted balance* net of interest expenditure on *general government* debt. See also *interest burden*.

**Debt dynamics** The evolution of *government debt* as a ratio to GDP; it depends on the primary deficit, the debt-increasing impact of interest payments, the dampening effect of GDP growth on the ratio and the *stock-flow adjustment*.

**EDP notification** See *notification of deficit and debt*.

**ERM II** Exchange rate mechanism linking some currencies of non-euro Member States to the euro, which is the centre of the mechanism. For the currency of each Member State participating in the mechanism, a central rate against the euro and a standard fluctuation band of ±15% are defined.

**ESA95** European accounting standards for the compilation and reporting of macroeconomic (including budgetary) data by the EU Member States.

**Excessive deficit procedure (EDP)** A procedure, laid down in the EC Treaty, according to which the Commission and the Council monitor the development of national *budget balances* and *public debt* in relation to the *reference values*, in order to assess the existence (or risk) of an excessive deficit in each Member State and to ensure its correction. Its application has been further clarified in the *Stability and Growth Pact*.

**Fiscal stance** A measure of the thrust of discretionary fiscal policy such as, in this document, the change in the *structural balance* (or in the *structural primary balance*) relative to the preceding year. When the change is positive (negative) the fiscal stance is said to be restrictive (expansionary).

**Funded pension scheme** Pension system in which current pension expenditures are financed by running down assets accumulated over the years on the basis of contributions by the scheme beneficiaries. According to *ESA95*, defined-contribution funded pension schemes are not considered as part of the *general government* sector. See also *pay-as-you-go pension scheme*.

**Government debt** See *public debt*.

**General government** The focus of EU budgetary surveillance under the *Stability and Growth Pact* and the *excessive deficit procedure* is on general government aggregates, with the general government sector covering national, regional and local government, as well as social security. In principle, public enterprises are excluded.

**Government net lending/borrowing** See *budget balance*.

**Implicit liabilities** Future government expenditure which has not yet been funded, even when future expenditure is not backed by law or contractual obligations, but is simply grounded in strong expectations of the public. To be meaningful for economic analysis, implicit liabilities should be assessed net of future revenue assuming that the government will keep collecting taxes (and other non-tax revenue) at rates comparable to current levels. See also *contingent liabilities*.

**Interest burden** *General government* interest expenditure on *government debt* as a share of GDP.

**Intertemporal budget constraint** A basic condition imposing that current total liabilities of the government, i.e. the current public debt and the discounted value of future expenditure including the budgetary impact of ageing populations, be covered by the discounted value of future government revenue.

**Lisbon strategy** Partnership between the EU and Member States for growth and more and better jobs. Originally approved in 2000, the Lisbon Strategy was revamped in 2005. Based on the Integrated Guidelines (merger of the *broad economic policy guidelines* and the employment guidelines, dealing with macro-economic, micro-economic and employment issues) for the period 2005-2008, Member States drew up 3-year national reform programmes in autumn 2005. They reported on the implementation of the national reform programmes for the first time in autumn 2006. The Commission analyses and summarises these reports in an EU Annual Progress Report each year, in time for the Spring European Council.

**Long-term sustainability** A combination of *budget balance* and *public debt* that ensures that the latter does not grow without bound. While conceptually intuitive, an agreed operational definition of sustainability has proven difficult to achieve.

**Maturity structure of public debt** The profile of *public debt* in terms of when it is due to be paid back. Interest rate changes affect the *budget balance* directly to the extent that the *general government* sector has debt with a relatively short maturity structure. Long maturities reduce the sensitivity of the *budget balance* to changes in the prevailing interest rate. See also *interest burden*.

**Medium-term objective (MTO)** According to the *Stability and Growth Pact*, *stability programmes* and *convergence programmes* must present a medium-term objective for the budgetary position. It is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances, and is defined in structural terms (see *structural balance*).

**Minimum benchmark** Estimated budgetary position (in *cyclically-adjusted* terms) that provides a "safety margin" that is enough for the *automatic stabilisers* to operate freely during normal economic slowdowns without breaching the 3% of GDP deficit *reference value*. The minimum benchmarks are estimated by the European Commission. They do not cater for other risks such as unexpected budgetary developments and interest rate shocks.

**National reform programme (NRP)** See *Lisbon strategy*.

**Notification of deficit and debt (EDP notification)** Twice a year (by 1 April and 1 October), EU Member States have to notify their *general government* deficit and debt figures (and a number of associated data) to the Commission, the quality of which is then checked by Eurostat, the Commission department in charge of statistics. See also *budget balance* and *public debt*.

**One-off and temporary measures** Government transactions having a transitory budgetary effect that does not lead to a sustained change in the intertemporal budgetary position. See also *structural balance*.

**Output gap** The difference between actual GDP and potential GDP in any given year, usually expressed as a percent of potential GDP. Potential GDP is an unobserved variable and needs to be estimated from actual data. It is the level of real GDP in a given year that is consistent with a stable rate of inflation. If actual output rises above its potential level, then constraints on capacity begin to bind and inflationary

pressures build; if output falls below potential, then resources are lying idle and inflationary pressures abate. See also *production function method*.

**Pay-as-you-go pension scheme (PAYG)** Pension system in which current pension expenditures are financed by the contributions of current employees. Also known as *unfunded pension scheme*. See also *funded pension scheme*.

**Primary balance** The *budget balance* net of interest expenditure on *general government* debt. See also *interest burden*.

**Pro-cyclical fiscal policy** A *fiscal stance* which amplifies the economic cycle by lowering the *structural balance* when the *output gap* is positive or improving, or by increasing the *structural balance* when the *output gap* is negative or widening, as opposed to a counter-cyclical fiscal policy stance. A neutral fiscal policy keeps the *structural balance* unchanged over the economic cycle by letting the *automatic stabilisers* work.

**Production function method** A method to estimate potential GDP typically based on a Cobb-Douglas production function. Potential GDP is estimated as the level of GDP consistent with a full utilisation of capital, an unemployment rate that does not accelerate inflation and factor productivity at its trend level. See also *output gap, cyclically-adjusted balance, budgetary sensitivity*.

**Public debt (or government debt)** Consolidated gross debt for the *general government* sector. It includes the total nominal value of all debt owed by government units, except that part of the debt which is owed to government units in the same Member State. It is a gross debt measure meaning that government financial assets on other sectors are not netted out. See also *debt dynamics* and *reference values*.

**Public investment** The component of total public expenditure which consists in the acquisition of durable assets and through which governments increase and improve the stock of capital employed in the production of the goods and services they provide. Also known as government gross fixed capital formation (GFCF).

**Public-private partnerships (PPP)** Agreements between government and corporations according to which the latter build and operate public-use infrastructure (roads, tunnels, bridges, but also hospitals, prisons, concert halls, etc.) which were traditionally directly controlled by government. In exploiting the infrastructure, the corporation receives prices paid by final users, rentals or fees from the government or both. Infrastructure built under PPPs is considered as either *public investment* or corporate investment depending on a number of specific criteria.

**Quality of public finances** A multi-dimensional concept which refers to the contribution that public finances make to the efficient allocation of resources in the economy and to achieving the government's strategic objectives (sustainable growth, macroeconomic stability, competitiveness, social cohesion etc.). It concerns notably the overall level of expenditure and taxation, their composition, the budgeting and control mechanisms and the institutional arrangements for deciding on public finance issues.

**Reference values for public deficit and debt** Respectively, a 3 percent *general government* deficit-to-GDP ratio and a 60 percent *general government* debt-to-GDP ratio. See also *excessive deficit procedure, government debt* and *budget balance*.

**Sensitivity analysis** An econometric or statistical simulation designed to test the robustness of an estimated economic relationship or projection to changes in the underlying assumptions.

**'Snow-ball' effect** The self-reinforcing effect of *public debt* accumulation or decumulation arising from a positive or negative differential between the implicit interest rate on public debt and the GDP growth rate. See also *debt dynamics*.

**Stability and Growth Pact (SGP)** Approved in 1997 and reformed in 2005, the SGP clarifies the provisions on budgetary surveillance in the EC Treaty. The "preventive" arm of the SGP obliges Member States to submit annual *stability programmes* or *convergence programmes*, while the "corrective" arm of the SGP clarifies and speeds up the *excessive deficit procedure*.

**Stability programme** Medium-term budgetary strategy presented by each Member State that has already adopted the euro; updated annually, according to the provisions of the *Stability and Growth Pact*. See also *convergence programme, code of conduct* and *medium-term objective*.

**Stock-flow adjustment (SFA)** The stock-flow adjustment (also known as the debt-deficit adjustment) ensures consistency between *government net borrowing*, which is a flow variable, and the variation in *government debt*, which is a stock variable. It includes differences between cash and accrual accounting, accumulation of financial assets, changes in the value of debt denominated in foreign currency and remaining statistical adjustments. See also *debt dynamics*.

**Structural balance** The *budget balance* in *cyclically-adjusted* terms and excluding *one-off and temporary measures*. See also *fiscal stance*.

**Structural primary balance** The *structural balance* net of interest expenditure on *general government* debt. See also *interest burden*.

**Tax elasticity** A parameter measuring the relative change in tax revenues with respect to a relative change in GDP. The tax elasticity is an input to the *budgetary sensitivity*.

## Annex 2: Summary tables from the programme update

The tables below present the information provided in the programme in the format prescribed by the code of conduct (Annex 2 thereof).

**Table 1a. Macroeconomic prospects**

| | ESA Code | 2005 Level | 2005 rate of change | 2006 rate of change | 2007 rate of change | 2008 rate of change | 2009 rate of change | 2010 rate of change |
|---|---|---|---|---|---|---|---|---|
| 1. Real GDP | B1*g | 240.6 | 2.0 | 3.1 | 2.7 | 2.3 | 2.5 | 2.6 |
| 2. Nominal GDP | B1*g | 245.103 | 3.9 | 4.6 | 4.4 | 4.0 | 3.9 | 4.0 |
| Components of real GDP | | | | | | | | |
| 3. Private consumption expenditure | P.3 | 135.251732 | 1.7 | 1.8 | 2.1 | 2.0 | 2.0 | 2.0 |
| 4. Government consumption expenditure | P.3 | 43.5159263 | 1.9 | 0.9 | 1.6 | 1.6 | 1.0 | 0.7 |
| 5. Gross fixed capital formation | P.51 | 49.3318613 | 0.3 | 4.7 | 4.9 | 3.4 | 3.0 | 2.9 |
| 6. Changes in inventories and net acquisition of valuables (% of GDP) | P.52 + P.53 | 0.26708159 | -0.2 | -0.1 | 0.1 | 0.0 | 0.2 | -0.2 |
| 7. Exports of goods and services | P.6 | 129.522438 | 6.4 | 8.5 | 7.1 | 6.2 | 6.2 | 6.6 |
| 8. Imports of goods and services | P.7 | 117.456375 | 5.2 | 6.8 | 7.7 | 6.6 | 6.0 | 6.0 |
| Contributions to real GDP growth | | | | | | | | |
| 9. Final domestic demand | | 0 | 1.4 | 1.9 | 2.5 | 2.2 | 1.8 | 2.1 |
| 10. Changes in inventories and net acquisition of valuables | P.52 + P.53 | 0 | -0.2 | -0.1 | 0.1 | 0.0 | 0.2 | -0.2 |
| 11. External balance of goods and services | B.11 | 0 | 0.9 | 1.3 | 0.1 | 0.1 | 0.4 | 0.7 |

**Table 1b. Price developments**

| | ESA Code | 2005 level | 2005 rate of change | 2006 rate of change | 2007 rate of change | 2008 rate of change | 2009 rate of change | 2010 rate of change |
|---|---|---|---|---|---|---|---|---|
| 1. GDP deflator | | | 1.9 | 1.3 | 1.7 | 1.7 | 1.2 | 1.3 |
| 2. Private consumption deflator | | | 1.7 | 1.5 | 1.6 | 1.7 | 1.6 | 1.8 |
| 3. HICP[1] | | | 2.1 | 1.5 | 1.6 | 1.7 | 1.7 | 1.8 |
| 4. Public consumption deflator | | | 2.2 | 2.2 | 1.9 | 1.9 | 1.8 | 1.7 |
| 5. Investment deflator | | | 1.9 | 1.8 | 2.7 | 1.9 | 1.8 | 2.5 |
| 6. Export price deflator (goods and services) | | | 2.7 | 2.4 | 1.1 | 0.7 | 2.8 | 2.7 |
| 7. Import price deflator (goods and services) | | | 3.4 | 3.3 | 1.1 | 0.7 | 3.9 | 3.7 |

[1] Optional for Stability programmes.

**Table 1c. Labour market developments**

| | ESA Code | 2005 Level | 2005 rate of change | 2006 rate of change | 2007 rate of change | 2008 rate of change | 2009 rate of change | 2010 rate of change |
|---|---|---|---|---|---|---|---|---|
| 1. Employment, persons[1] | | 3,500,403 | 1.3 | 1.6 | 1.3 | 0.7 | 0.7 | 0.7 |
| 2. Employment, hours worked[2] | | 6885.298 | 0.8 | | | | | |
| 3. Unemployment rate (%)[3] | | 207700 | 5.2 | 4.8 | 4.5 | 4.2 | 4.1 | 3.9 |
| 4. Labour productivity, persons [4] | | 68745.6049 | 0.8 | 1.5 | 1.4 | 1.6 | 1.8 | 1.9 |
| 5. Labour productivity, hours worked[5] | | 34.9494418 | 1.2 | | | | | |
| **6. Compensation of employees** | D.1 | 119.404375 | 2.9 | 4.6 | 3.9 | 3.2 | 3.4 | 3.6 |

[1] Occupied population, domestic concept national accounts definition.
[2] National accounts definition.
[3] Harmonised definition, Eurostat; levels.
[4] Real GDP per person employed.
[5] Real GDP per hour worked.

**Table 1d. Sectoral balances**

| % of GDP | ESA Code | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| **1. Net lending/borrowing vis-à-vis the rest of the world** | B.9 | 1.3 | 1.9 | 1.8 | 1.9 | 1.9 | 1.9 |
| **of which:** | | | | | | | |
| - Balance on goods and services | | | | | | | |
| - Balance of primary incomes and transfers | | | | | | | |
| - Capital account | | | | | | | |
| 2. Net lending/borrowing of the private sector | B.9/EDP B.9 | | | | | | |
| 3. Net lending/borrowing of general government | B.9 | -1.5 | -1.1 | -0.9 | -0.7 | -0.2 | 0.4 |
| **4. Statistical discrepancy** | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

58

**Table 2. General government budgetary prospects**

| | ESA code | 2006 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| | | Level | % of GDP | % of GDP | % of GDP | % of GDP | % of GDP |
| **Net lending (EDP B.9) by sub-sector** | | | | | | | |
| | | -2.9 | -1.1 | -0.9 | -0.7 | -0.2 | 0.4 |
| 1. General government | S.13 | | | | | | |
| 2. Central government | S.1311 | -3.8 | -1.5 | -1.3 | -1.2 | -0.7 | -0.2 |
| 3. State government | S.1312 | 0.6 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| 4. Local government | S.1313 | 0.4 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 |
| 5. Social security funds | S.1314 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **General government (S13)** | | | | | | | |
| 6. Total revenue | TR | 123.0 | 48.0 | 47.6 | 47.4 | 47.2 | 47.1 |
| 7. Total expenditure | TE[1] | 126.2 | 49.2 | 48.7 | 48.3 | 47.5 | 46.9 |
| 8. Net lending/borrowing | EDP B.9 | -2.9 | -1.1 | -0.9 | -0.7 | -0.2 | 0.4 |
| 9. Interest expenditure (incl. FISIM) | EDP D.41 incl. FISIM | 7.7 | 3.0 | 2.9 | 2.9 | 2.8 | 2.7 |
| pm: 9a. FISIM | | 0.4 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| 10. Primary balance | [2] | 4.9 | 1.9 | 2.0 | 2.1 | 2.6 | 3.1 |
| Selected components of revenue | | | | | | | |
| 11. Total taxes (11=11a+11b+11c) | | 69.8 | 27.2 | 27.1 | 27.1 | 27.0 | 27.0 |
| 11a. Taxes on production and imports | D.2 | 35.9 | 14.0 | 13.9 | 13.8 | 13.6 | 13.5 |
| 11b. Current taxes on income, wealth, etc | D.5 | 33.7 | 13.2 | 13.2 | 13.3 | 13.3 | 13.4 |
| 11c. Capital taxes | D.91 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| 12. Social contributions | D.61 | 41.0 | 16.0 | 15.8 | 15.8 | 15.7 | 15.6 |
| 13. Property income | D.4 | 3.5 | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 |
| 14. Other (14=15-(11+12+13)) | | 8.6 | 3.3 | 3.4 | 3.3 | 3.3 | 3.3 |
| 15=6. Total revenue | TR | 123.0 | 48.0 | 47.6 | 47.4 | 47.2 | 47.1 |
| p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[3] | | | | | | | |
| Selected components of expenditure | | | | | | | |
| 16. Collective consumption | P.32 | 17.7 | 6.9 | 6.9 | 7.1 | 6.7 | 6.6 |
| 17. Total social transfers | D.62 + D.63 | 75.2 | 29.3 | 29.1 | 28.9 | 28.7 | 28.5 |
| 17a. Social transfers in kind | P.31 = D.63 | 28.2 | 11.0 | 10.9 | 10.9 | 10.9 | 10.9 |
| 17b. Social transfers other than in kind | D.62 | 47.0 | 18.3 | 18.1 | 18.0 | 17.8 | 17.6 |
| 18.=9. Interest expenditure (incl. FISIM) | EDP D.41 incl. FISIM | 7.7 | 3.0 | 2.9 | 2.9 | 2.8 | 2.7 |
| 19. Subsidies | D.3 | 8.2 | 3.2 | 2.9 | 2.9 | 2.9 | 2.9 |
| 20. Gross fixed capital formation | P.51 | 2.7 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 |
| 21. Other (21=22-(16+17+18+19+20)) | | 14.6 | 5.7 | 5.7 | 5.4 | 5.2 | 5.1 |
| 22=7. Total expenditure | TE[4] | 126.2 | 49.2 | 48.7 | 48.3 | 47.5 | 46.9 |
| Pm: compensation of employees | D.1 | | | | | | |

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41 + FISIM recorded as intermediate consumption, item 9).

[3] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[4] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

**Table 3. General government expenditure by function**

| % of GDP | COFOG Code | 2005 | 2009 |
|---|---|---|---|
| 1. General public services | 1 | 6.8 | |
| 2. Defence | 2 | 0.9 | |
| 3. Public order and safety | 3 | 1.4 | |
| 4. Economic affairs | 4 | 5.0 | |
| 5. Environmental protection | 5 | 0.3 | |
| 6. Housing and community amenities | 6 | 0.5 | |
| 7. Health | 7 | 6.9 | |
| 8. Recreation, culture and religion | 8 | 1.0 | |
| 9. Education | 9 | 5.9 | |
| 10. Social protection | 10 | 20.6 | |
| 11. Total expenditure (= item 7=26 in Table 2) | TE[1] | **49.5** | |

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

**Table 4. General government debt developments**

| % of GDP | | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| 1. Gross debt[1] | | | 62.2 | 61.2 | 59.9 | 58.5 | 56.8 |
| 2. Change in gross debt ratio | | | -1.2 | -1.0 | -1.3 | -1.4 | -1.6 |
| **Contributions to changes in gross debt** | | | | | | | |
| 3. Primary balance[2] | | | 1.9 | 2.0 | 2.1 | 2.6 | 3.1 |
| 4. Interest expenditure (incl. FISIM) [3] | | | 3.0 | 2.9 | 2.8 | 2.8 | 2.7 |
| 5. Stock-flow adjustment | | | 0.5 | 0.7 | 0.3 | 0.6 | 1.0 |
| - Differences between cash and accruals[4] | | | | | | | |
| - Net accumulation of financial assets[5] | | | | | | | |
| of which - privatisation proceeds | | | | | | | |
| - Valuation effects and other[6] | | | | | | | |
| p.m. implicit interest rate on debt[7] | | | 4.8 | 4.7 | 4.7 | 4.7 | 4.7 |
| **Other relevant variables** | | | | | | | |
| 6. Liquid financial assets[8] | | | | | | | |
| 7. Net financial debt (7=1-6) | | | | | | | |

[1] As defined in Regulation 3605/93 (not an ESA concept).
[2] Cf. item 10 in Table 2.
[3] Cf. item 9 in Table 2.
[4] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.
[5] Liquid assets, assets on third countries, government controlled enterprises
[6] Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.
[7] Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.
[8] AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

**Table 5. Cyclical developments**

| % of GDP | ESA Code | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| **1. Real GDP growth (%)** | | | 3.1 | 2.7 | 2.3 | 2.5 | 2.6 |
| **2. Net lending of general government** | EDP B.9 | | -1.1 | -0.9 | -0.7 | -0.2 | 0.4 |
| **3. Interest expenditure (incl. FISIM recorded as consumption)** | EDPD.41 + FISIM | | 3.0 | 2.9 | 2.8 | 2.8 | 2.7 |
| 4. Potential GDP growth (%) (1) | | | 2.0 | 2.2 | 2.3 | 2.3 | 2.2 |
| contributions: | | | | | | | |
| - labour | | | 0.2 | 0.3 | 0.3 | 0.2 | 0.2 |
| - capital | | | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| - total factor productivity | | | 1.0 | 1.1 | 1.1 | 1.2 | 1.2 |
| 5. Output gap | | | -0.3 | 0.1 | 0.2 | 0.4 | 0.8 |
| 6. Cyclical budgetary component | | | -0.2 | 0.1 | 0.1 | 0.2 | 0.4 |
| 7. Cyclically-adjusted balance (2-6) | | | -0.9 | -1.0 | -0.8 | -0.4 | 0.0 |
| 8. Cyclically-adjusted primary balance (7-3) | | | 2.0 | 1.9 | 2.0 | 2.4 | 2.7 |

(1) Until an agreement on the Production Function Method is reached, Member States can use their own figures (*SP*)

**Table 6. Divergence from previous update**

| | ESA Code | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| **Real GDP growth (%)** | | | | | | | |
| Previous update | | 1.7 | 1.8 | 2.4 | 2.5 | | |
| Current update | | 2.0 | 3.1 | 2.7 | 2.3 | | |
| Difference | | 0.3 | 1.3 | 0.3 | -0.2 | | |
| | | | | | | | |
| **General government net lending (% of GDP)** | EDP B.9 | | | | | | |
| Previous update | | -1.9 | -1.7 | -0.8 | 0.0 | | |
| Current update | | -1.5 | -1.1 | -0.9 | -0.7 | | |
| Difference | | 0.4 | 0.6 | -0.1 | -0.7 | | |
| **General government gross debt (% of GDP)** | | | | | | | |
| Previous update | | 63.4 | 63.1 | 61.6 | 59.5 | | |
| Current update | | 63.4 | 62.2 | 61.2 | 59.9 | | |
| Difference | | 0.0 | -0.9 | -0.4 | 0.4 | | |

**Table 7. Long-term sustainability of public finances**

| % of GDP | 2000 | 2005 | 2010 | 2020 | 2030 | 2040 | 2050 |
|---|---|---|---|---|---|---|---|
| Total expenditure | | | | | | | |
| Of which: age-related expenditures | | **25.9** | **24.6** | **25.1** | **27.1** | | **26.1** |
| Pension expenditure | | 14.1 | 13.4 | 13.7 | 15.0 | | 13.1 |
| Social security pension | | 10.4 | 10.1 | 10.7 | 12.2 | | 11.9 |
| Old-age and early pensions | | | | | | | |
| Other pensions (disability, survivors) | | | | | | | |
| Occupational pensions (if in general government) | | | | | | | |
| Health care | | 5.3 | 5.4 | 5.9 | 6.3 | | 6.8 |
| Long-term care *(this was earlier included in the health care)* | | 0.6 | 0.6 | 0.8 | 1.0 | | 1.5 |
| Education expenditure | | | | | | | |
| Other age-related expenditures | | 5.9 | 5.2 | 4.7 | 4.8 | | 4.7 |
| Interest expenditure | | | | | | | |
| Total revenue | | | | | | | |
| Of which: property income | | | | | | | |
| *of which*: from pensions contributions (or social contributions if appropriate) Pension reserve fund assets | | 8.9 | 9.0 | 9.0 | 8.9 | | 8.7 |
| Of which: consolidated public pension fund assets (assets other than government liabilities) | | | | | | | |
| **Assumptions** | | | | | | | |
| Labour productivity growth | | **1.8** | **1.9** | **1.8** | **1.7** | | **1.7** |
| Real GDP growth | | **2.0** | **2.2** | **1.6** | **1.0** | | **1.2** |
| Participation rate males (aged 20-64) | | **75.4** | **76.8** | **80.3** | **79.9** | | **80.3** |
| Participation rates females (aged 20-64) | | **62.0** | **65.4** | **70.5** | **70.7** | | **71.6** |
| Total participation rates (aged 20-64) | | **68.6** | **71.2** | **75.4** | **75.3** | | **76.0** |
| Unemployment rate | | **5.2** | **3.9** | **3.9** | **3.9** | | **3.9** |
| Population aged 65+ over total population | | **23.6** | **26.3** | **30.3** | **40.8** | | **53.2** |

**Table 8. Basic assumptions**

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| **Short-term interest rate[1] (annual average)** | | | 3.1 | 3.7 | 3.6 | 2.5 | 2.5 |
| **Long-term interest rate (annual average)** | | | 3.8 | 4.0 | 4.2 | 4.0 | 4.1 |
| **USD/€ exchange rate (annual average) (euro area and ERM II countries)** | | | 1.25 | 1.35 | 1.42 | 1.39 | 1.37 |
| **Nominal effective exchange rate** | | | 0.2 | 0.6 | 0.4 | 0.0 | 0.0 |
| **(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)** | | | | | | | |
| **World excluding EU, GDP growth** | | | 5.7 | 5.2 | 5.2 | 3.1 | 3.1 |
| **EU GDP growth** | | | 2.8 | 2.4 | 2.4 | 2.3 | 2.3 |
| **Growth of relevant foreign markets** | | | 10.3 | 7.5 | 8.5 | 7.0 | 6.0 |
| **World import volumes, excluding EU** | | | 9.1 | 8.3 | 7.9 | 7.0 | 6.0 |
| **Oil prices, (Brent, USD/barrel)** | | | 65.4 | 60.0 | 61.0 | 63.0 | 65.0 |

[1] If necessary, purely technical assumptions.

## Annex 3: Compliance with the code of conduct

The table below provides a detailed assessment of whether the programme respects the requirements of Section II of the code of conduct. It is in four parts, covering compliance with (i) the window for the date of submission of the programme; (ii) the model structure (table of contents) in Annex 1 of the code; (iii) the data requirements (model tables) in Annex 2 of the code; and (iv) other information requirements.

| Guidelines in the code of conduct | Yes | No | Comments |
|---|---|---|---|
| **1. Submission of the programme** | | | |
| Programme was submitted not earlier than mid-October and not later than 1 December[1]. | | X | Formation of new government |
| **2. Model structure** | | | |
| The model structure for the programmes in Annex 1 of the code of conduct has been followed. | X | | |
| **3. Model tables (so-called data requirements)** | | | |
| The quantitative information is presented following the standardised set of tables (Annex 2 of the code of conduct). | X | | |
| The programme provides all compulsory information in these tables. | X | | |
| The programme provides all optional information in these tables. | | X | |
| The concepts used are in line with the European system of accounts (ESA). | X | | |
| **4. Other information requirements** | | | |
| *a. Involvement of parliament* | | | |
| The programme mentions its status vis-à-vis the national parliament. | | X | |
| The programme indicates whether the Council opinion on the previous programme has been presented to the national parliament. | | X | |
| *b. Economic outlook* | | | |
| Euro area and ERM II Member States uses the "common external assumptions" on the main extra-EU variables. | | | WIFO assumptions as well as the common external assumptions have been used in the SP |
| Significant divergences between the national and the Commission services' economic forecasts are explained[2]. | | X | |
| The possible upside and downside risks to the economic outlook are brought out. | X | | |
| The outlook for sectoral balances and, especially for countries with a high external deficit, the external balance is analysed. | X | | |
| *c. Monetary/exchange rate policy* | | | |
| The convergence programme presents the medium-term monetary policy objectives and their relationship to price and exchange rate stability. | | | Not applicable. |
| *d. Budgetary strategy* | | | |
| The programme presents budgetary targets for the general government balance in relation to the MTO, and the projected path for the debt ratio. | X | | |
| In case a new government has taken office, the programme shows continuity with respect to the budgetary targets endorsed by the Council. | | X | Yes with MTO, no with target date |
| When applicable, the programme explains the reasons for possible deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify the situation, and provide information on them. | | X | Yes until 2006, no until 2008 |
| The budgetary targets are backed by an indication of the broad measures necessary to achieve them and an assessment of their | | X | Additional table provided but without |

| Guidelines in the code of conduct | Yes | No | Comments |
|---|---|---|---|
| quantitative effects on the general government balance is analysed. | | | link to standard table |
| Information is provided on one-off and other temporary measures. | X | | |
| The state of implementation of the measures (enacted versus planned) presented in the programme is specified. | | X | "Yes" for 2007/2008 |
| If for a country that uses the transition period for the classification of second-pillar funded pension schemes, the programme presents information on the impact on the public finances. | | | Not applicable. |
| *e. "Major structural reforms"* | | | |
| If the MTO is not yet reached or a temporary deviation is planned from the achieved MTO, the programme includes comprehensive information on the economic and budgetary effects of possible 'major structural reforms' over time. | | | Not applicable. |
| The programme includes a quantitative cost-benefit analysis of the short-term costs and long-term benefits of such reforms. | | | Not applicable. |
| *f. Sensitivity analysis* | | | |
| The programme includes comprehensive sensitivity analyses and/or develops alternative scenarios showing the effect on the budgetary and debt position of:<br>a) changes in the main economic assumptions<br>b) different interest rate assumptions<br>c) for non-participating Member States, different exchange rate assumptions<br>d) if the common external assumptions are not used, changes in assumptions for the main extra-EU variables. | X | | No scenario on interest rates |
| In case of "major structural reforms", the programme provides an analysis of how changes in the assumptions would affect the effects on the budget and potential growth. | | | Not applicable. |
| *g. Broad economic policy guidelines* | | | |
| The programme provides information on the consistency with the broad economic policy guidelines of the budgetary objectives and the measures to achieve them. | | X | |
| *h. Quality of public finances* | | | |
| The programme describes measures aimed at improving the quality of public finances on both the revenue and expenditure side (e.g. tax reform, value-for-money initiatives, measures to improve tax collection efficiency and expenditure control). | X | | |
| *i. Long-term sustainability* | | | |
| The programme outlines the country's strategies to ensure the sustainability of public finances, especially in light of the economic and budgetary impact of ageing populations. | X | | |
| Common budgetary projections by the AWG are included in the programme. The programme includes all the necessary additional information. (…) To this end, information included in programmes should focus on new relevant information that is not fully reflected in the latest common EPC projections. | X | | |
| *j. Other information (optional)* | | | |
| The programme includes information on the implementation of existing national budgetary rules (expenditure rules, etc.), as well as on other institutional features of the public finances, in particular budgetary procedures and public finance statistical governance. | X | | See Chapter 7 of the SP |

Notes:

[1]The code of conduct allows for the following exceptions: (i) Ireland should be regarded as complying with the deadline in case of submission on "budget day", i.e. traditionally the first Wednesday of December, (ii) the UK should submit as close as possible to its autumn pre-budget report; and (iii) Austria and Portugal cannot comply with the deadline but will submit no later than 15 December.

[2]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

*Source:*

*Commission services*

**Annex 4: Key economic indicators of past economic performance**

This Annex includes two tables. The first displays key economic indicators that summarise the economic performance of the country. To put the country's performance into perspective, the second table displays the same set of indicators for the euro area.

## Austria – key economic indicators

| | Averages | | | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| | 1996 – 2005 | 1996 – 2000 | 2001 - 2005 | | | |
| **Economic activity** | | | | | | |
| Real GDP (% change) | 2.2 | 2.9 | 1.5 | 1.1 | 2.4 | 2.0 |
| Private consumption % change | 1.7 | 2.2 | 1.2 | 1.3 | 1.9 | 1.7 |
| Government consumption % change | 1.5 | 2.0 | 1.0 | 1.2 | 1.4 | 1.9 |
| Investment % change | 1.6 | 3.3 | -0.2 | 5.9 | 0.6 | 0.3 |
| Exports % change | 7.1 | 8.2 | 5.9 | 2.0 | 10.0 | 6.4 |
| Imports % change | 5.8 | 6.7 | 4.8 | 5.1 | 8.7 | 5.2 |
| Contributions to real GDP growth | | | | | | |
| Demand | | | | | | |
| *Domestic demand* | 1.5 | 2.3 | 0.8 | 2.3 | 1.5 | 1.2 |
| *Net exports* | 0.6 | 0.6 | 0.7 | -1.3 | 0.9 | 0.9 |
| Output gap | -0.1 | 0.5 | -0.7 | -1.5 | -1.1 | -1.3 |
| **Prices and costs** | | | | | | |
| HICP inflation % change | 1.6 | 1.2 | 1.9 | 1.3 | 2.0 | 2.1 |
| Unit labour costs % change | 0.2 | -0.2 | 0.7 | 1.1 | -0.4 | 0.9 |
| Labour productivity % change | 1.6 | 2.2 | 1.0 | 0.9 | 2.1 | 0.7 |
| Real unit labour costs % change | -0.9 | -1.0 | -0.9 | -0.3 | -2.1 | -0.9 |
| Comparative price levels (EUR25=100) | 106.5 | 107.9 | 105.1 | 106.4 | 104.3 | 103.7 |
| **Labour market** | | | | | | |
| Employment % change | 0.6 | 1.0 | 0.2 | 0.1 | 0.0 | 0.3 |
| Employment % of pop work age | 75.0 | 75.0 | 75.0 | 75.0 | 74.5 | 74.1 |
| Unemployment rate in % | 4.3 | 4.1 | 4.4 | 4.3 | 4.8 | 5.2 |
| NAIRU in % | 4.1 | 3.9 | 4.4 | 4.3 | 4.6 | 4.8 |
| Participation rate in % | 78.0 | 77.9 | 78.2 | 78.0 | 78.0 | 77.9 |
| Working age population % change | 0.5 | 0.3 | 0.7 | 0.7 | 0.6 | 0.9 |
| **Competitiveness and external position** | | | | | | |
| Real effective exchange rate % change (1) | -1.7 | -3.3 | -0.1 | 2.6 | -0.3 | -1.0 |
| Export performance % change (2) | 0.6 | -0.4 | 1.6 | -2.4 | 1.6 | 0.2 |
| External balance of g & s | 2.4 | 0.8 | 4.0 | 3.6 | 4.3 | 4.8 |
| Net borrowing v-à-v RoW | 0.1 | -1.4 | 1.6 | 1.7 | 1.9 | 2.8 |
| FDI | 2.2 | 2.3 | 2.0 | 2.8 | 1.3 | 2.9 |
| **Public finances** | | | | | | |
| Total expenditure % of GDP | 51.9 | 53.3 | 50.6 | 51.1 | 50.3 | 49.9 |
| Total revenue % of GDP | 50.2 | 50.9 | 49.5 | 49.3 | 49.0 | 48.3 |
| General government balance % of GDP | -1.6 | -2.3 | -1.0 | -1.6 | -1.2 | -1.5 |
| General government debt % of GDP | 65.1 | 65.6 | 64.7 | 64.6 | 63.8 | 63.4 |
| Structural budget balance % of GDP | n.a. | n.a. | n.a. | -0.9 | -0.7 | -0.9 |
| **Fin.a.ncial indicators (3)** | | | | | | |
| Short term real interest rate (4) | 2.0 | 2.8 | 1.2 | 1.0 | 0.4 | 0.3 |
| Long term real interest rate (4) | 3.7 | 4.6 | 2.7 | 2.8 | 2.4 | 1.5 |
| Household credit % change | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Corporate sector credit % change (5) | 6.2 | 9.1 | 3.3 | 4.3 | 0.3 | 5.7 |
| Household debt in % of GDP | n.a. | 44.5 | n.a. | 48.2 | 50.3 | n.a. |
| Corporate sector debt in % of GDP | 73.4 | 68.7 | 78.0 | 79.3 | 76.2 | 77.5 |

Notes:

(1) ulc relative to rest of a group of industrialised countries (usd): EUR24 (excl. LU), BG, RO, TR, CH, NR, US, CA, JP, AU, MX and

(2) Market performance of exports of goods and services on export weighted imports of goods and services of 35 industrial markets (2000=100).

(3) Data available up to 2005

(4) Using GDP deflator

(5) Households' and non-profit institutions serving households' debt defined as loans and securities other than shares

(6) Non-financial corporate sector debt, defined as loans and securities other than shares

## Euro area – key economic indicators

| | Averages | | | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| | 1996 – 2005 | 1996 – 2000 | 2001 - 2005 | | | |
| **Economic activity** | | | | | | |
| Real GDP (% change) | 2.1 | 2.7 | 1.4 | 0.8 | 2.0 | 1.4 |
|    Private consumption (% change) | 2.0 | 2.6 | 1.4 | 1.2 | 1.5 | 1.3 |
|    Government consumption (% change) | 1.7 | 1.7 | 1.8 | 1.8 | 1.2 | 1.4 |
|    Investment (% change) | 2.6 | 4.3 | 1.0 | 1.0 | 2.1 | 2.7 |
|    Exports (% change) | 5.8 | 8.1 | 3.5 | 1.1 | 6.8 | 4.2 |
|    Imports (% change) | 5.9 | 8.4 | 3.4 | 3.1 | 6.7 | 5.3 |
| Contributions to real GDP growth (percentage points) | | | | | | |
|    *Domestic demand* | 2.0 | 2.7 | 1.3 | 1.4 | 1.8 | 1.7 |
|    *Net exports* | 0.1 | 0.0 | 0.1 | -0.7 | 0.2 | -0.3 |
| Output gap | -0.1 | -0.2 | 0.1 | -0.5 | -0.3 | -0.9 |
| **Prices and costs** | | | | | | |
| HICP inflation (% change) | 1.9 | 1.7 | 2.2 | 2.1 | 2.1 | 2.2 |
| Unit labour costs (% change) | 1.3 | 0.8 | 1.7 | 2.0 | 0.9 | 1.0 |
| Labour productivity (% change) | 1.2 | 1.5 | 0.8 | 0.8 | 1.6 | 0.9 |
| Real unit labour costs (% change) | -0.5 | -0.6 | -0.5 | -0.1 | -1.0 | -0.8 |
| Comparative price levels (EUR25=100) | 73.6 | 73.9 | 73.2 | 73.2 | 72.9 | 72.7 |
| **Labour market** | | | | | | |
| Employment (% change) | 1.2 | 1.5 | 0.9 | 0.7 | 0.7 | 0.8 |
| Employment (in % of working age population) | 63.7 | 62.0 | 65.4 | 65.4 | 65.6 | 65.8 |
| Unemployment rate (in % of labour force) | 9.1 | 9.8 | 8.5 | 8.7 | 8.9 | 8.6 |
| NAIRU (in % of labour force) | 8.7 | 9.0 | 8.5 | 8.5 | 8.4 | 8.3 |
| Participation rate (in % of working age population) | 69.9 | 68.5 | 71.2 | 71.4 | 71.7 | 71.8 |
| Working age population (% change) | 0.3 | 0.2 | 0.4 | 0.5 | 0.5 | 0.4 |
| **Competitiveness and external position** | | | | | | |
| Real effective exchange rate (% change) (1) | | | | | | |
| Export performance (% change) (2) | : | : | : | : | : | : |
| External balance of g & s (in % of GDP) | 1.9 | 1.7 | 2.0 | 2.1 | 2.1 | 1.5 |
| Net borrowing v-à-v RoW (in % of GDP) | : | : | : | : | : | : |
| FDI inflow (in % of GDP) | | | | | | |
| **Public finances** | | | | | | |
| Total expenditure (in % of GDP) | 48.1 | 48.5 | 47.7 | 48.2 | 47.5 | 47.5 |
| Total revenue (in % of GDP) | 45.8 | 46.4 | 45.1 | 45.1 | 44.7 | 45.1 |
| General government balance (in % of GDP) | -2.3 | -2.1 | -2.5 | -3.0 | -2.8 | -2.4 |
| General government debt (in % of GDP) | 70.8 | 72.3 | 69.3 | 69.3 | 69.8 | 70.8 |
| Structural budget balance (in % of GDP) | : | : | : | -3.2 | -2.9 | -2.2 |
| **Financial indicators (4)** | | | | | | |
| Short term real interest rate (in %) (5) | 1.7 | 2.7 | 0.7 | 0.2 | 0.2 | 0.3 |
| Long term real interest rate (in %) (5) | 3.1 | 4.1 | 2.1 | 2.0 | 2.2 | 1.5 |
| Household debt (% change) (6) | | | | | | |
| Corporate sector debt (% change) (7) | | | | | | |
| Household debt (in % of GDP) (6) | | | | | | |
| Corporate sector debt (in % of GDP) (7) | | | | | | |

Notes:

(1) Unit labour costs relative to rest of a group of industrialised countries (usd): EUR24 (excl. LU), BG, RO, TR, CH, NR, US, CA, JP, AU, MX and NZ.

(2) Market performance of exports of goods and services on export weighted imports of goods and services of 35 industrial markets.

(3) Cyclically-adjusted budget balance net of one-off and other temprary measures.

(4) Data available up to 2005.

(5) Using GDP deflator.

(6) Households' and non-profit institutions serving households' debt defined as loans and securities other than shares.

(7) Non-financial corporate sector debt, defined as loans and securities other than shares.

*Source* :

Commission services

## Annex 5: Assessment of tax projections

Table 9 in the main text compares the tax projections of the programme with those of the Commission services' spring 2007 forecast and those obtained by using standard ex-ante elasticities, as estimated by the OECD. It summarises the results for the total tax-to-GDP ratio. The underlying analysis exploits information for the four major tax categories, i.e. indirect taxes, corporate and private income taxes and social contributions (see results in the table below)[19].

Conceptually, the analysis draws on the definition of a semi-elasticity, which measures the change in a ratio vis-à-vis the relative change in the denominator. The semi-elasticity of the tax-to-GDP ratio of the *i-th* tax $\dfrac{T_i}{Y}$ can be written as:

$$\eta_i = \frac{d\left(\dfrac{T_i}{Y}\right)}{dY}Y = \left(\frac{dT_i}{dY}\frac{Y}{T_i}-1\right)\frac{T_i}{Y} = \left(\frac{dT_i}{dB_i}\frac{B_i}{T_i}\frac{dB_i}{dY}\frac{Y}{B_i}-1\right)\frac{T_i}{Y} = (\varepsilon_{T_i,B_i}\varepsilon_{B_i,Y}-1)\frac{T_i}{Y}$$

where $\varepsilon_{T_i,B_i}$ and $\varepsilon_{B_i,Y}$ denote the elasticity of the *i-th* tax $T_i$ relative to its tax base $B_i$ and the elasticity of the tax base $B_i$ relative to aggregate GDP $Y$ respectively.

To the extent that $\varepsilon_{T_i,B_i}$ is derived from observed or projected data, it will typically reflect (i) the effect of discretionary measures (including one-offs) and (ii) the tax elasticity[20]. By contrast, if $\varepsilon_{T_i,B_i}$ is the standard *ex-ante* elasticity, as estimated by the OECD, it will be net of discretionary measures.

The second elasticity $\varepsilon_{B_i,Y}$ can be used as an indicator of the tax intensity of GDP growth; for instance, a higher elasticity of consumption relative to GDP means that for the same GDP growth indirect taxes will be higher.

The definition of a semi-elasticity has two practical implications. First, any change in the tax-to-GDP ratio of the *i-th* tax can be written as the product of the semi-elasticity and GDP growth:

$$d\left(\frac{T_i}{Y}\right) = \eta_i \cdot \frac{dY}{Y}$$

and the change in the total tax-to-GDP ratio is the sum:

$$\sum_i d\left(\frac{T_i}{Y}\right) = \sum_I \eta_i \frac{dY}{Y} \ .$$

Second, differences between two tax projections can be decomposed into an elasticity component and a composition component:

$$d\left(\frac{T_i}{Y}\right)' - d\left(\frac{T_i}{Y}\right) \approx \left[(\varepsilon'_{T_i,B_i}\varepsilon'_{B_i,Y}-1)\frac{T_i}{Y} - (\varepsilon_{T_i,B_i}\varepsilon_{B_i,Y}-1)\frac{T_i}{Y}\right]\frac{dY}{Y}$$

---

[19]Private and corporate income taxes are generally not provided, neither in the programme nor in the Commission services' autumn 2006 forecast. Only the aggregate, direct income taxes, is given. For the purpose of this exercise the breakdown is obtained using the average shares over the past ten years, i.e. the composition of direct taxes is assumed to stay constant.

[20]The observed or projected elasticity (ex-post elasticity) of the *i*-th tax also includes the effect of other factors (OF) such as discretionary measures: $\dfrac{\Delta T_i}{T_i} = \varepsilon_{T_i,B_i ex ante}\dfrac{dB_i}{B_i} + \dfrac{OF_i}{T_i} = \varepsilon_{T_i,B_i ex post}\dfrac{dB_i}{B_i}$ .

If $(\varepsilon'_{T_i,B_i} - \varepsilon_{T_i,B_i}) = \alpha_i; \quad (\varepsilon'_{B_i,Y} - \varepsilon_{B_i,Y}) = \beta_i,$

then $d\left(\dfrac{T_i}{Y}\right)' - d\left(\dfrac{T_i}{Y}\right) \approx \left[\left(\alpha_i \varepsilon_{B_i,Y} + \beta_i \varepsilon_{T_i,B_i} + \alpha_i \beta_i\right)\dfrac{T_i}{Y}\right]\dfrac{dY}{Y}$

where $\alpha_i \varepsilon_{B_i,Y} \dfrac{T_i}{Y}\dfrac{dY}{Y}$ determines the elasticity component and $\beta_i \varepsilon_{T_i,B_i} \dfrac{T_i}{Y}\dfrac{dY}{Y}$ the composition

component. The third component in the equation $\alpha_i \beta_i \dfrac{T_i}{Y}\dfrac{dY}{Y}$ measures the interaction of the

elasticity and the composition components. It is generally small but can become important in

some cases. The tax elasticity relative to GDP of total taxes is obtained as $\varepsilon = \sum_i w_i \varepsilon_{T_i B_i} \varepsilon_{B_i Y}$

with $w_i$ the share of the *i-th* tax in the overall tax burden.

## Assessment of tax projections by major tax category

| | 2007 | | | 2008 | | | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| | SP | COM | OECD[1] | SP | COM[2] | OECD[1] | SP | SP |
| **Taxes on production and imports:** | | | | | | | | |
| Change in tax-to-GDP ratio | -0.1 | -0.3 | 0.0 | -0.1 | -0.2 | 0.0 | -0.1 | -0.1 |
| *Difference SP – COM* | 0.1 | | | 0.1 | | | / | / |
| *of which [3]:* | | | | | | | | |
| *- discretionary & elasticity component* | 0.1 | | | 0.0 | | | / | / |
| *- composition component* | 0.0 | | | 0.0 | | | / | / |
| *Difference COM – OECD* | / | -0.3 | | / | -0.2 | | / | / |
| *of which [3]:* | | | | | | | | |
| *- discretionary & elasticity component* | / | -0.1 | | / | -0.2 | | / | / |
| *- composition component* | / | -0.2 | | / | -0.1 | | / | / |
| p.m.: Elasticity | | | | | | | | |
| - of taxes to tax base[4] | 0.9 | 0.8 | 1.0 | 0.8 | 0.7 | 1.0 | 0.8 | 0.9 |
| - of tax base[4] to GDP | 0.8 | 0.7 | 1.0 | 0.9 | 0.8 | 1.0 | 0.9 | 1.0 |
| **Social contributions:** | | | | | | | | |
| Change in tax-to-GDP ratio | -0.2 | -0.2 | -0.3 | -0.1 | -0.1 | -0.3 | -0.1 | -0.1 |
| *Difference SP – COM* | 0.0 | | / | 0.1 | | / | / | / |
| *of which [3]:* | | | | | | | | |
| *- discretionary & elasticity component* | 0.0 | | / | 0.0 | | / | / | / |
| *- composition component* | 0.0 | | / | 0.0 | | / | / | / |
| *Difference COM – OECD* | / | 0.1 | | / | 0.1 | | / | / |
| *of which [3]:* | | | | | | | | |
| *- discretionary & elasticity component* | / | -0.1 | | / | 0.0 | | / | / |
| *- composition component* | / | 0.2 | | / | 0.1 | | / | / |
| p.m.: Elasticity | | | | | | | | |
| - of taxes to tax base[5] | 0.9 | 0.9 | 1.0 | 1.1 | 1.0 | 1.0 | 1.0 | 1.0 |
| - of tax base[5] to GDP | 0.9 | 0.9 | 0.6 | 0.8 | 0.8 | 0.6 | 0.9 | 0.9 |
| **Personal income tax[6]:** | | | | | | | | |
| Change in tax-to-GDP ratio | 0.0 | -0.1 | 0.1 | 0.1 | 0.0 | 0.1 | 0.0 | 0.1 |
| *Difference SP – COM* | 0.1 | | / | 0.0 | | / | / | / |
| *of which [3] :* | | | | | | | | |
| *- discretionary & elasticity component* | 0.1 | | / | 0.0 | | / | / | / |
| *- composition component* | 0.0 | | / | 0.0 | | / | / | / |
| *Difference COM – OECD* | / | -0.2 | | / | -0.1 | | / | / |
| *of which [3] :* | | | | | | | | |
| - discretionary & elasticity component | / | -0.4 | | / | -0.2 | | / | / |
| *- composition component* | / | 0.3 | | / | 0.2 | | / | / |
| p.m.: Elasticity | | | | | | | | |
| - of taxes to tax base[5] | 1.2 | 1.0 | 2.2 | 1.4 | 1.4 | 2.2 | 1.3 | 1.3 |
| - of tax base[5] to GDP | 0.9 | 0.9 | 0.6 | 0.8 | 0.8 | 0.6 | 0.9 | 0.9 |
| **Corporate income tax[6] :** | | | | | | | | |
| Change in tax-to-GDP ratio | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| *Difference SP – COM* | 0.0 | | / | 0.0 | | / | / | / |
| *of which [3] :* | | | | | | | | |
| *- discretionary & elasticity component* | 0.0 | | / | 0.0 | | / | / | / |
| *- composition component* | 0.0 | | / | 0.0 | | / | / | / |
| *Difference COM – OECD* | / | 0.1 | | / | 0.1 | | / | / |
| *of which [3] :* | | | | | | | | |
| *- discretionary & elasticity component* | / | -0.1 | | / | 0.0 | | / | / |
| *- composition component* | / | 0.2 | | / | 0.1 | | / | / |
| p.m.: Elasticity | | | | | | | | |
| -of taxes to tax base[7] | 0.9 | 0.7 | 1.0 | 1.0 | 0.9 | 1.0 | 1.0 | 1.1 |
| -of tax base[7] to GDP | 1.1 | 1.1 | 0.6 | 1.2 | 1.2 | 0.6 | 1.1 | 1.1 |

Notes:

[1] Based on OECD ex-ante elasticities

[2] On a no-policy change basis

[3] The decomposition is explained in the text above

[4] Tax base = private consumption expenditure

[5] Tax base = compensation of employees

[6] Taxes on income and wealth are split into private and corporate income tax using the average tax share over the past ten years, i.e. the share is assumed to be constant over the programme period

[7] Tax base = gross operating surplus

*Source:*

*Commission services' spring 2007 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)*