COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 30.5.2007
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Recommendation for a

COUNCIL OPINION

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

On the updated stability programme of Austria, 2006-2010

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

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

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

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of Austria, submitted on 29 March 2007, and has adopted a recommendation for a Council opinion on it (see box for the main points covered by the assessment).

In order to set the scene against which the budgetary strategy in the updated stability programme is assessed, the following paragraphs summarise:

(1) the economic and budgetary performance over the last ten years

(2) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the stability programme) and

(3) the Commission's assessment of the September 2006 national reform programme.

[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). All the documents referred to in this text can be found at the following website: http://ec.europa.eu/economiy_finance/about/activities/sgp/main_en.htm

2.1. Recent economic and budgetary performance

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 and particularly from the EU accession of its neighbouring 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 from the mid-1990s, leading to a balanced position in 2001 but relapsing into a small deficit in the years after. Significant reforms in public administration, pension and health care aimed at reducing the general government deficit have been implemented, but there still remains room for improvement in these areas.

2.2. The assessment in the Council opinion on the previous programme

On 14 February 2006, the Council adopted its opinion on the previous update of the stability programme, covering the period 2005-2008. The Council welcomed "the ambitious structural adjustment planned over the programme period" but invited Austria "to make sure that the programme’s MTO is achieved by the end of the update period by further specifying and implementing the necessary measures that will support the budgetary consolidation planned for the two final years of the programme".

2.3. The Commission assessment of the September 2006 national reform programme

The implementation report of the national reform programme of Austria, provided for in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 25 September 2006. Austria's national reform programme identifies seven strategic priority areas: public finance sustainability, R&D and innovation, infrastructure, international competitiveness, the environment, labour market, and education and training.

The Commission’s assessment of this programme (adopted as part of its December 2006 Annual Progress Report[2]) showed that Austria is making good progress in the implementation of its National Reform Programme, especially in the micro-economic area. Against the background of strengths and weaknesses identified, Austria was recommended to take action in the area of employment, in particular lifelong learning, the tax-benefit system and youth qualification. In addition, it was considered important for Austria, among other things, to achieve the target of a balanced budget in 2008.

2 Communication from the Commission to the Spring European Council, “Implementing the renewed Lisbon strategy for growth and jobs - A year of delivery” - COM(2006) 816, 12.12.2006.

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;
- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' spring 2007 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. The assessment of consistency with the broad economic policy guidelines is made against the broad economic policy guidelines in the area of public finances as included in the integrated guidelines for the period 2005-2008.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability[3];
- the degree of integration with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;
- compliance with the code of conduct[4], which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

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[3] Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU" - COM(2006) 574, 12.10.2006 - and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

[4] "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.

Recommendation for a

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

On the updated stability programme of Austria, 2006-2010

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [9 July 2007] the Council examined the updated stability programme of Austria, which covers the period 2006 to 2010. Following the general elections in October 2006, a new government was formed in January 2007, which presented the twin budget for 2007/2008 to Parliament on 29 March 2007. On the same day, the updated stability programme was submitted, two and a half months after the 15 December deadline for Austria in the code of conduct.

(2) The macroeconomic scenario underlying the 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.

(3) 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

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[5] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

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

(4) 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 further the planned adjustment against a broadly more favourable macroeconomic scenario.

(5) The postponement of the budgetary adjustment is reflected also in the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology, which improves only very gradually from a deficit of around 1 % of GDP in 2006 and swings to a slight surplus only by the end of the programme period. 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. 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. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1½ % of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro-area and ERM II Member States in the Stability and Growth Pact and the code of conduct and adequately reflects the debt ratio and average potential output growth in the long term.

(6) 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 on education, R&D and infrastructure 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.

(7) In view of this 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, which specifies that, for euro-area and ERM II Member States, the annual improvement in the structural balance should be 0.5 % of GDP as a benchmark and that the adjustment should be higher in good economic times and could be lower in bad economic times. 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.

(8) Government gross debt is estimated to have declined to 62.2 % of GDP in 2006, still being above the 60 % of GDP Treaty reference value. The programme projects the debt ratio to fall below the reference value by 2008 and to decline further to 56.8 % of GDP by the final year of the programme period. In view of the risk assessment, 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.

(9) 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. The initial budgetary position, with a structural primary surplus, contributes to easing the long-term budgetary impact of ageing. Increasing primary surpluses over the medium-term, as announced in the programme, as well as an increase in the employment rate of older workers would contribute towards containing risks to the sustainability of public finances. Overall, Austria appears to be at low risk with regard to the sustainability of public finances.

(10) The stability programme does not contain 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 no systematic information on the direct budgetary costs or savings of the main reforms envisaged in the National Reform Programme and its budgetary projections do not explicitly take into account the public finance implications of the actions outlined in the National Reform Programme. Those measures in the area of public finances that are cited 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.

(11) The budgetary strategy in the programme is partly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data[6].

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.

In view of the above assessment, Austria is invited to exploit the good economic conditions and the lower-than-targeted deficit in 2006 to frontload and strengthen the adjustment towards the MTO, in particular by rigorously implementing expenditure restraint and by using any unexpected tax revenues for consolidation.

[6] However, optional data on employment and hours worked as well as public sector wages are not provided.

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 (purchase of military aircraft of 0.2% of GDP in 2007, 0.4% in 2008 and 0.1% in 2009).

[4] Compared with the programme (see note 3), the Commission services' spring 2007 forecast does not consider the purchase of military aircraft as one-offs, since it spreads over several years and does not substantially increase total government expenditure.

[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