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**AUSTRIA: MACRO FISCAL ASSESSMENT**  
**AN ANALYSIS OF THE NOVEMBER 2007 UPDATE OF THE STABILITY**  
**PROGRAMME**

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 21 November 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 (DG ECFIN) of the European Commission, was finalised on 26 February 2008. Comments should be sent to Monika Sherwood ([monika.sherwood@ec.europa.eu](mailto:monika.sherwood@ec.europa.eu)). The main aim of the 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.

The analysis takes into account (i) the Commission services’ autumn 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. Technical issues are explained in an accompanying “methodological paper” prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 13 February 2008. The ECOFIN Council is expected to adopt its opinion on the programme on 4 March 2008.

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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](http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm)

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## SUMMARY AND CONCLUSIONS

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 2007-2010, was submitted on 21 November 2007.

Over the last few years, Austria has experienced robust economic growth, surpassing that of other euro area countries on average. With private consumption being sluggish, the main contributions to growth came from net exports and investment. Continued wage moderation helped to maintain price stability while boosting external competitiveness. The Austrian labour market has been performing well, with the unemployment rate being one of the lowest in the EU and the overall employment rate higher than the 70% target of the Lisbon strategy. However, the employment rate of older workers remains well below the EU average. With public debt in excess of 60% of GDP, the general government deficit has been declining since 2005, but the achievement of a balanced budget has been repeatedly postponed. Lasting consolidation of public finances will hinge also on an overhaul of fiscal relations between different government levels as the present ones are overly complicated and lack transparency.

The macroeconomic scenario underlying the programme envisages that real GDP growth will decelerate from 3.4% in 2007 to 2.5% on average over the rest of the programme period. Assessed against currently available information<sup>1</sup>, this scenario appears to be broadly plausible. Net exports' contribution to growth is expected to diminish significantly in 2008 and to recover thereafter. The profile of private consumption growth will remain quite flat, whereas a marked slowdown is expected in investment growth. Given the latest developments in food and oil prices, inflation could turn out somewhat higher than projected in the programme, but the continued wage moderation should contribute towards maintaining high degree of competitiveness. With output gap turning and remaining positive throughout the programme period, Austria is expected to continue experiencing good economic times in the near future.

For 2007, the general government deficit is estimated at 0.7% of GDP in the most recent update of the stability programme, against a target of 0.9% of GDP set in the previous update. This improvement over the target results mainly from the better-than-expected cyclical developments, with revenue exceeding the budgetary plans and slightly offsetting higher-than-planned expenditure growth. In particular, proceeds from wage and corporate taxes as well as capital yields taxes gave rise to the higher-than-planned revenue.

The main goal of the medium-term budgetary strategy is to reach the medium-term objective (MTO) - a balanced position in structural terms (i.e. in cyclically-adjusted terms net of one-off and other temporary measures) - by 2010. The headline general government balance is planned to swing from a deficit of 0.7% of GDP in 2007 to a 0.4% of GDP surplus in 2010, with a back-loaded adjustment. The primary surplus is expected to improve somewhat less - by 0.9 percentage points of GDP - during the period. The structural deficit, calculated according to the commonly agreed methodology, will

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<sup>1</sup> The assessment takes notably into account the Commission services' autumn forecast and the Commission assessment of October 2007 implementation report of the national reform programme.

narrow by about 1 percentage point of GDP between 2007 and 2010<sup>2</sup>. With revenue-to-GDP ratio remaining almost unchanged throughout the programme period, the consolidation relies largely on expenditure cuts, with restraint in social spending and gains from administrative reforms being the main factors. Compared with the previous programme, which envisaged that the MTO would be nearly reached in 2009, the new update slightly backloads the planned adjustment despite a more favourable growth performance in 2007. Government gross debt, estimated at just below the 60% of GDP Treaty reference value in 2007, is projected to decline by 4.5 percentage points over the programme period.

The risks to the budgetary projections in the programme appear broadly balanced for 2008, but for 2009 and 2010 the budgetary outcomes could be worse than projected, despite plausible macroeconomic assumptions. In particular, the programme does not provide sufficient information about the measures that are necessary to underpin the significant expenditure restraint envisaged in the last two years of the programme, although savings on unemployment benefits and on pensions, as a result of the 2004 pension reform, should contribute to the decline in the expenditure ratio. It is also not clear how the expenditure targets allow for the planned additional spending on education, R&D and infrastructure over the programme period, while the expected efficiency gains in public administration remain uncertain. Finally, the programme announces tax cuts for 2010 without making any provision for financing them. The risks to the projected evolution of the debt ratio appear to be broadly balanced, with on the one hand potentially higher-than-targeted deficits endangering adherence to the adjustment path presented in the programme, but on the other hand, nominal GDP possibly turning out higher than foreseen.

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. However, a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations will be provided throughout the programme period. In 2008, the pace of adjustment towards the MTO implied by the programme is insufficient and should be strengthened significantly to be in line with the Stability and Growth Pact. After 2008, the planned adjustment should be backed up with specific expenditure-saving measures.

With regard to the sustainability of public finances, Austria appears to be at low risk. The long-term budgetary impact of ageing is lower than the EU average, with pension expenditure projected to decrease as a share of GDP over the long term. The budgetary position in 2007 as estimated in the programme, which is better than the starting position of the previous programme, contributes to easing the projected long-term budgetary impact of ageing populations. Maintaining high primary surpluses over the medium term, as planned in the programme, would further contribute to limiting risks to the sustainability of public finances.

Austria's national reform programme identifies the following as key areas: sustainability of public finances, labour market and employment, R&D and innovation, infrastructure,

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<sup>2</sup> If one treated the additional expenditure for military equipment as a one-off measure (which the programme does as reported in the overview table below, even though the Commission services do not), the adjustment in structural deficit would be by 0.2 percentage point lower than if these one-off measures are disregarded.

business environment, education and training, as well as environmental and resource management. The October 2007 implementation report added "social security system as productive force" as the eighth priority. In its Strategic Report of 11 December 2007<sup>3</sup>, the Commission concluded that Austria had made significant progress in implementing its national reform programme over the 2005-2007 period.

The stability programme is fully consistent with the implementation report of the national reform programme. Focussing on the measures with a direct budgetary impact, both the stability programme and the implementation report provide for a shift in spending towards growth-orientated categories, such as R&D, infrastructure and education. Likewise, the implementation report contains information on the reforms of the public administration, health care system, as well as on the introduction of a new medium-term budgetary framework, all of which are key elements of the budgetary consolidation path presented in the stability programme. However, the budgetary strategy in the programme is only partly consistent with the country-specific broad economic policy guidelines issued in the context of the Lisbon strategy, as the structural improvement towards the MTO does not appear to be sufficient.

The overall conclusion is that in a context of growth remaining close to its potential, the programme envisages slow progress towards the MTO through a relatively back-loaded adjustment that is based 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. The update makes no provision for financing the tax cuts announced for 2010. Government debt is expected to have decreased to just below the 60% of GDP reference value in 2007 and to continue to decline moderately in future years. In terms of long-term sustainability of public finances, Austria appears to be at low risk.

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<sup>3</sup> Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", 11.12.2007, COM(2007)803.

## Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	<b>SP Nov 2007</b>	<b>3.3</b>	<b>3.4</b>	<b>2.4</b>	<b>2.5</b>	<b>2.5</b>
	COM Nov 2007	3.3	3.3	2.7	2.4	n.a.
	<i>SP Mar 2007</i>	<i>3.1</i>	<i>2.7</i>	<i>2.3</i>	<i>2.5</i>	<i>2.6</i>
HICP inflation (%)	<b>SP Nov 2007</b>	<b>1.5</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>
	COM Nov 2007	1.7	1.9	1.9	1.8	n.a.
	<i>SP Mar 2007</i>	<i>1.5</i>	<i>1.6</i>	<i>1.7</i>	<i>1.7</i>	<i>1.8</i>
Output gap <sup>1</sup> (% of potential GDP)	<b>SP Nov 2007</b>	<b>-0.5</b>	<b>0.4</b>	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>
	COM Nov 2007 <sup>2</sup>	-0.4	0.4	0.8	0.8	n.a.
	<i>SP Mar 2007</i>	<i>-0.3</i>	<i>0.1</i>	<i>-0.1</i>	<i>0.1</i>	<i>0.3</i>
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	<b>SP Nov 2007</b>	<b>3.2</b>	<b>3.5</b>	<b>3.7</b>	<b>3.7</b>	<b>3.7</b>
	COM Nov 2007	3.3	4.6	5.2	5.3	n.a.
	<i>SP Mar 2007</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
General government balance (% of GDP)	<b>SP Nov 2007</b>	<b>-1.4</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.2</b>	<b>0.4</b>
	COM Nov 2007	-1.4	-0.8	-0.7	-0.4	n.a.
	<i>SP Mar 2007</i>	<i>-1.1</i>	<i>-0.9</i>	<i>-0.7</i>	<i>-0.2</i>	<i>0.4</i>
Primary balance (% of GDP)	<b>SP Nov 2007</b>	<b>1.5</b>	<b>2.0</b>	<b>2.1</b>	<b>2.3</b>	<b>2.8</b>
	COM Nov 2007	1.4	1.7	1.8	2.0	n.a.
	<i>SP Mar 2007</i>	<i>1.9</i>	<i>2.0</i>	<i>2.1</i>	<i>2.6</i>	<i>3.1</i>
Cyclically-adjusted balance <sup>1</sup> (% of GDP)	<b>SP Nov 2007</b>	<b>-1.2</b>	<b>-0.9</b>	<b>-0.8</b>	<b>-0.4</b>	<b>0.1</b>
	COM Nov 2007	-1.2	-1.0	-1.0	-0.8	n.a.
	<i>SP Mar 2007</i>	<i>-1.0</i>	<i>-0.9</i>	<i>-0.7</i>	<i>-0.2</i>	<i>0.2</i>
Structural balance <sup>3</sup> (% of GDP)	<b>SP Nov 2007</b>	<b>-1.2</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.4</b>	<b>0.1</b>
	COM Nov 2007	-1.2	-1.0	-1.0	-0.8	n.a.
	<i>SP Mar 2007</i>	<i>-1.0</i>	<i>-0.8</i>	<i>-0.4</i>	<i>-0.2</i>	<i>0.2</i>
Government gross debt (% of GDP)	<b>SP Nov 2007</b>	<b>61.7</b>	<b>59.9</b>	<b>58.4</b>	<b>57.0</b>	<b>55.4</b>
	COM Nov 2007	61.7	60.0	58.4	57.2	n.a.
	<i>SP Mar 2007</i>	<i>62.2</i>	<i>61.2</i>	<i>59.9</i>	<i>58.5</i>	<i>56.8</i>

Notes:

<sup>1</sup>Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

<sup>2</sup>Based on estimated potential growth of 2.2% in 2006 and 2.4% in 2007-2009.

<sup>3</sup>Cyclically-adjusted balance excluding one-off and other temporary measures. According to the most recent programme one-off and other temporary measures are 0.2% of GDP in 2007 and 2008 and 0.1% of GDP in 2009; all deficit-increasing (spending on military equipment). There are no one-off and other temporary measures in the Commission services' autumn forecast as the Commission services do not consider this expenditure on military equipment as a one-off.

Source:

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



## **1. INTRODUCTION**

The latest update of the stability programme was adopted by the Austrian Council of Ministers and submitted to the European Commission and the Council on 21 November 2007<sup>4</sup>. The update covers the period from 2007 till 2010.

This assessment is further structured as follows. Section 2 discusses key challenges for public finances in Austria, with a particular focus on reforming federal fiscal relations. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts. Section 4 analyses budgetary implementation in the year 2007 and the medium-term budgetary strategy outlined in the new programme. Taking into account risks attached to the budgetary targets, it also assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses the quality of public finances and structural reforms, while Section 7 analyses the consistency of the budgetary strategy outlined in the programme with the national reform programme and its implementation reports and with the broad economic policy guidelines. The annexes provide a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme (Annex 1) and selected key indicators of past economic performance (Annex 2).

## **2. KEY CHALLENGES FOR PUBLIC FINANCES WITH A PARTICULAR FOCUS ON REFORMING FEDERAL FISCAL RELATIONS**

For many years, the Austrian authorities have stated as their goal to achieve a balanced budget over the business cycle. This scenario has not materialised yet as surpluses were not in sight in good times to make up for deficits registered in less favourable economic conditions. The date for achieving a balanced budget has been systematically postponed in consecutive updates. In the assessment of the previous update of the stability programme, the Commission services concluded that in spite of many significant reforms, which contributed to the reduction in the general government deficit, there was still room for improvement in the pension and health care systems, as well as in some other areas. Substantial efficiency gains in those areas could be obtained by reforming the fiscal relations between the various layers of government.

Austria is a federation, where government responsibilities are shared among three different territorial levels: federal, regional (9 States) and local (2357 municipalities). As in other similarly organised countries, the reasoning behind the federal structure is that it provides increased efficiency from the decentralisation of allocative functions and that public services should be produced and financed in accordance with the preferences of the residents of the area that enjoys the benefits<sup>5</sup>. Compared with the degree of fiscal decentralisation in other countries, Austria is at a medium range in terms of the share of

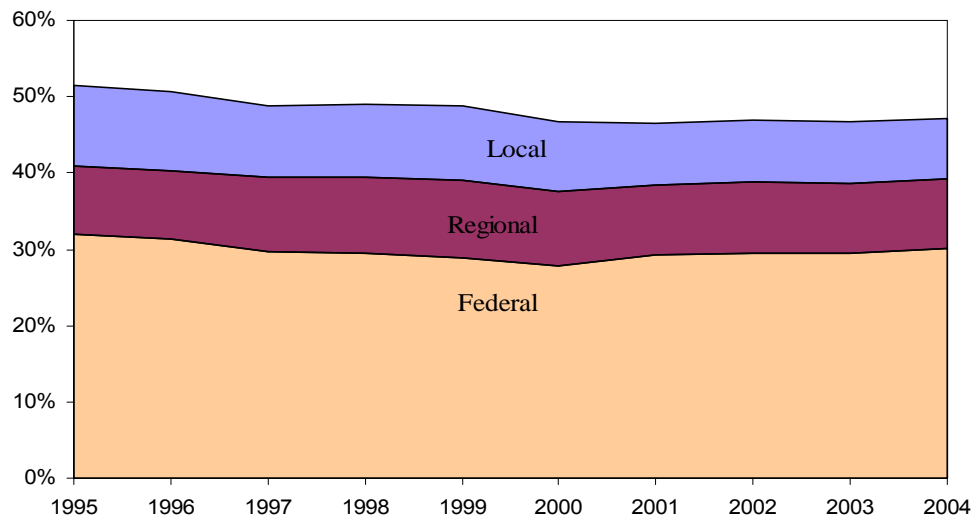
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<sup>4</sup> The English version of the programme arrived on 29 November 2007.

<sup>5</sup> Balassone F. and D. Franco (2005), *Fiscal federalism in Fiscal Policy in Economic and Monetary Union*, Edward Elgar, Cheltenham, UK

sub-national government outlays in total public sector spending and at the lower-medium end when it comes to the contribution of sub-national governments' own revenue to total public sector revenue<sup>6</sup>.

**Figure 1: Spending by various layers of government as percentage of GDP**



*Source: OECD, National Accounts*

The relations between the three layers of government in Austria are governed by the Fiscal Equalisation Law (Finanzausgleichsgesetz - FAG) and the Austrian Stability Pact (ASP). The rules, set out in the FAG and ASP, are rather complex and lacking in transparency. Not only are revenues from most individual taxes shared among the different territorial levels by fixed proportions, but also decision-making in many areas is divided among various levels of authority. Revenue-raising and spending responsibilities for different activities do not reside within the same level of government. In its present form, the system does not encourage the agents involved to use resources in the most efficient way and keep firm control over spending. Therefore, there is considerable potential for increasing efficiency in the public sector.

This section will first set out the main features of the FAG and the issues that arose during the negotiations of its latest version to be in force from 2008 till 2013. Secondly, the Austrian Stability Pact will be briefly presented and its effectiveness in enhancing fiscal consolidation will be looked at. Finally, the section will present several areas of federal fiscal relations where the need for reform is most acute.

## **2.1. The Fiscal Equalisation Law – main features**

The three layers of government coordinate their medium-term budgetary plans in the FAG, which allocates the revenues to territorial authorities, usually for the period of four years. The law specifies the types of taxes that are to be shared among the three levels of government, as well as the proportion at which they are to be divided among them. Most of the tax categories are collected by the federal government and then distributed to the three levels according to the key agreed on in the FAG negotiations. A part of the

<sup>6</sup> Bergvall, D. et al (2006), *Intergovernmental Transfers and Decentralised Public Spending*, OECD, Journal on Budgeting, Volume 5, No. 4

revenue from the shared taxes is withheld before the distribution to the various levels of government and earmarked for special purposes, e.g. financing of family benefits. The federal government receives about 73% of the remaining revenue from the shared taxes. The States and municipalities get about 15% and 12%, respectively<sup>7</sup>. A significant part of the shared revenue that flows to the regional and local governments is earmarked for special spending activities. Some of these flows require co-financing by the sub-national authorities. As a last step, the FAG determines a horizontal distribution of the revenue at the regional and local level.

Own tax resources (generated and collected within a given State or municipality) constitute a significant part of the local government revenue. However, the only significant tax parameter, which municipalities can set autonomously, is the real estate tax rate. Own tax resources are negligible in the case of the States, indicating a very low degree of the tax autonomy. In fact, by international comparison Austria is one of the countries where the share of own tax in the regional government's revenue is the lowest (about 2% of the total)<sup>8</sup>. Moreover, in the last two decades, the share of the own tax resources of sub-national governments in the total tax revenue declined by about 15 pp.<sup>9</sup> On the one hand, economic theory suggests that the central government should collect taxes from tax bases that are more mobile, more sensitive to cyclical factors and less uniformly distributed<sup>10</sup>. On the other hand, though, splitting the funding and spending powers, like in Austria, weakens the cost-benefit relationship associated with public services, thereby reducing the allocative advantages of a federal structure<sup>11</sup>.

## **2.2. The Fiscal Equalisation Law 2008-2013**

The negotiations on the future FAG finished in October 2007. In comparison to its predecessors, the period of validity of the FAG is now extended to six years (from four years previously), so the new FAG is supposed to be in force from 2008 till 2013. The extension of the period is meant to provide more predictability for budgetary planning by all three levels of government. However, it is understood that if a major reform of the constitution and/or public administration is introduced, the FAG would have to be renegotiated to take into account a new division of competences among the authority levels. It should also be noted that the previous FAG, which was supposed to be in place from 2004 till 2008, was shortened by one year in order to accommodate the programme of the new government.

The negotiations on the FAG are deemed the only instance in the political process when the federal government can exert pressure on the sub-national authorities to carry out reforms. The negotiation round on the latest FAG was perceived to be a missed

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<sup>7</sup> Fuentes, A. et al (2006), *Reforming federal fiscal relations in Austria*, OECD, Economic Department Working Papers no. 474

<sup>8</sup> Schratzenstaller, M. (2007), *Undurchschaubares Transfergeflecht* in der Standard, 25 October

<sup>9</sup> Pitlik, H. (2007), *Theoretische Eckpunkte einer grundlegenden Reform des aktiven Finanzausgleichs*, WIFO Monatsberichte 12

<sup>10</sup> Balassone F., Franco, D. (2005), *Fiscal federalism in Fiscal Policy in Economic and Monetary Union*, Edward Elgar, Cheltenham, UK

<sup>11</sup> Oates, W. (1972), *Fiscal Federalism*, New York: Harcourt Brace Jovanovich

opportunity for reforming the federal fiscal relations, notably because a grand coalition is in government, holding a two-thirds majority in the parliament - a necessary condition for introducing serious changes in the organisation of education and health care systems as well as in the division of competences between various levels of government.

### **2.3. The Austrian Stability Pact**

The Austrian Stability Pact (ASP) is an attempt to solve the asymmetry created by the high degree of decentralisation at national level on the one hand and the introduction – at the European level - of rules (i.e. Growth and Stability Pact) on the other, assigning responsibility for the general government balance solely to central governments. The ASP constitutes an enforcement mechanism which allocates the fiscal targets to be reached to the different levels of government (see Table 1.). In general, the pact is a useful tool aimed at involving all levels of government in the consolidation of public finances. In providing for legally enshrined budgetary commitments across various government levels, Austria may serve as a benchmark in the EU.

However, there is still room for improvement in terms of clarity of the ASP rules and transparency of the procedures accompanying it. In particular, in order to discourage fiscal recklessness the legally non-binding comments accompanying the government bill on the ASP specified that budgetary surpluses were initially meant to make up only for the slippages in the past and were not supposed to be carried over to future years<sup>12</sup>. However, compliance with the pact has apparently been interpreted by the federal and state levels as requiring that the stability contributions should be respected only on average over the pact's duration.

#### **Box 1: The Austrian Stability Pact**

The ASP was first set up informally in 1996 in the context of Austria's preparation for entering the euro area, which required significant fiscal consolidation. In 1999, this enforcement mechanism was formalised for the first time. Its successors were then adopted for the 2001-2004 and 2005-2008 periods. Following demands by the regional and local governments, the introduction of the pact was accompanied by the setting up of a "consultation mechanism" in order to ensure that no layer of government passes a law that puts financial strain on another level of government. The FAG foresees financial sanctions in case a State does not ratify the ASP.

The ASP prescribes deficit/surplus targets (so-called "stability contributions") to the federal, regional and local governments, supported by a sanctioning mechanism. The stability contributions were or still are subject to various adjustments before compliance with the ASP target was/is assessed. Firstly, until 2006 the ASP's accounting rules were not fully in line with those under ESA 95. Secondly, revised deficit targets can be negotiated among the governments in case of an exceptional burden, in particular such as revenue shortfalls and expenditure increases due to a severe economic slowdown. On top of that, certain deviation from a given year's target are allowed, as long as they are then offset in future years, so that on average the stability contributions are reached within the duration of the ASP for a given period.

A coordination committee among the different levels of government monitors compliance and would, if necessary, ask the Court of Auditors to establish a violation. Following a (non-public) report by the latter, a mediation committee would need to decide unanimously by February in the second year after the violation whether sanctions are due. The committee consists of two

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<sup>12</sup> Diebalek, L. et al (2005), *The Austrian Stability Pact 2001-2004 – Design, objectives and effectiveness*, Wirtschaftspolitische Blätter 2

representatives of the federal government and two representatives of state or local governments. The latter cannot be nominated by the state or commune that failed to comply with the pact. The ASP fixes the amount of the sanction (mechanism similar to that applicable under the European Stability and Growth Pact), which takes the form of an interest-bearing deposit. If in the following year the respective target is not reached, the deposit is transferred to those governments in compliance, and reimbursed otherwise. However, the ASP does not foresee publicity of procedures. Moreover, it still remains to be seen how enforceable the pact is, once there is a case established where the sanction mechanism needs to be activated.

It should also be noted that, striving to fulfil their obligation under the pact, all three layers of government resorted to a large extent to measures that could be qualified as creative accounting. In particular, all levels of authority used reclassification of public entities to the private sector. Here one of the most controversial issues is the reclassification of the state hospitals into the private sector and the consequent change of subsidies to the hospitals into loans, which according to ESA 95 are not deficit enhancing. The federal and regional governments also resorted to the transfer of real assets to various federal and regional real estate companies (the so-called “sell and lease back” method). Other techniques used by the States involved securitisation of outstanding loans and changing rules governing the housing assistance scheme so that housing subsidies were changed into loans.

Overall, it seems that in spite of it significantly failing to achieve its prescribed stability contributions in some years of the pact’s validity, only the federal government made steps towards the permanent reduction of expenditure. Meanwhile “state and local governments were not necessarily guided by the spirit of sustainability but at least partly motivated by the goal to achieve the agreed surpluses without paying too high political costs”<sup>13</sup>.

**Table 1: Stability contributions prescribed to various levels of government by the subsequent editions of the Austrian Stability Pact and actual outcomes**

Government level	1999		2000		2001			2002			2003		
	ASP planned	ESA 95 actual	ASP planned	ESA 95 actual	ASP planned	ESA 95 actual	ASP actual	ASP planned	ESA 95 actual	ASP actual	ASP planned	ESA 95 actual	ASP actual
General	-3	-2,2	-3	-1,5	-1,3	0	0,5	0	-0,5	0,3	0	-1,6	-0,8
Federal	-2,7	-2,4	-2,7	-1,6	-2,1	-0,8	-0,3	-0,75	-1,1	-0,7	-0,75	-1,9	-1,6
Regional	-0,2	0,3	-0,2	0,2	0,75	0,5	0,7	0,75	0,4	0,8	0,75	0,2	0,7
Local	-0,1	0	-0,1	0	0	0,3	0,1	0	0,3	0,1	0	0,2	0,0
Government level	2004		2005		2006		2007	2008	2008	2009	2010-13		
	ASP planned	ESA 95 actual	ASP actual	ASP planned	ESA 95 actual	ASP actual	ASP planned	ESA 95 actual	ASP planned old	ASP planned new	ASP planned	ASP planned	
General	0	-1,2	-0,8	-1,8	-1,6	-1,8	-1,6	-1,4	-0,7	0	-0,9	-0,2	0,4
Federal	-0,75	-1,4	-1,4	-2,4	-1,8	-1,8	-2,2	-1,4	-1,4	-0,8	-1,3	-0,7	-0,1
Regional	0,75	0,1	0,6	0,6	0,1	-0,1	0,6	-0,1	0,7	0,75	0,45	0,5	0,5
Local	0	0,2	0,0	0	0,2	0,1	0	0,2	0	0	0	0	0

*Note:* The table presents the targets and outcomes of the subsequent editions of the Austrian Stability Pact for the years 1999-2000, 2001-2004, 2005-2008 and 2008-2013  
*Source:* Austrian Ministry of Finance, Eurostat

As the actual budgetary outcomes for the three layers of government according to the ASP’s rules are only available for the years 2001-2005, it is probably too early to define trend in the degree of fulfilling the ASP’s assigned contributions. However, Table 1. conveys an early impression of compliance. Looking at the 2001-2004 edition of the ASP, it is apparent that the goals were adhered to only in the first two years. As the slippages, which occurred in the two last years, were significant, one may conclude that

<sup>13</sup> Diebalek, L. et al (2005), *The Austrian Stability Pact 2001-2004 – Design, objectives and effectiveness*, Wirtschaftspolitische Blätter 2

the set goals were unrealistic. This is also confirmed by the difference between the old and the new contributions foreseen for 2008 (under the 2005-2008 and 2008-2013 ASPs, respectively).

The newest ASP for the period 2008-2013 was negotiated together with the FAG for the same period. In contrast to its predecessors, which put the main burden of budgetary consolidation on the sub-national level, the new ASP foresees that the federal government is invited to gradually achieve balanced budgets.

## **2.4. Specific areas for reform**

In November 2005, the three layers of government agreed on the second stage of public administration reform<sup>14</sup> consisting mainly in reducing their staff by a total of almost 16 thousand, which was to result in a saving of nearly 2 billion euro (0.8% of GDP) between 2005 and 2010. Consensus was also reached on some other minor steps aimed at making the public administration more efficient, in particular in the education and health care sectors, but the measures agreed on were not defined in a sufficiently concrete way and potential savings were not quantified. The latest FAG keeps the planned reform almost intact. However, the reforms should go further than cutting government employee numbers and introducing small institutional changes.

Before the negotiations on the FAG 2008-2013 commenced, several proposals for reforms had been put forward, which mainly called for: stronger output orientation, disclosure and evaluation of outcomes, more responsibility and autonomy for the lower levels of government, less earmarking of revenue allocation, and introduction of additional incentives for more efficient use of resources. One positive result of the negotiations was the conversion of some of the transfers from the federal government to the state and local governments into revenue shares which are devoted to certain activities (e.g. housing assistance scheme and road maintenance). This introduced some transparency to the most opaque part of fiscal federal relations. Not many of the other ideas for change were discussed. In particular, the proposal to give more tax autonomy to the States quickly disappeared from the negotiating table due to the lack of willingness from their side to tackle the subject.

Instead, the new FAG foresees setting up a working group which is supposed to come up with proposals for the substantial reform of the FAG. The results of the work should be available by the end of 2010. There are many areas in the federal fiscal relations in Austria where streamlining of competences and of financing and spending responsibilities could potentially result in significant efficiency gains and reductions of public expenditure. This section presents those areas where the need for reform is most pressing and where the resulting expenditure cuts could be biggest. Many of the problems mentioned below could be fixed even before the next revamp of the FAG.

### *2.4.1. Pensions of government employees*

Following the pension reform of 2004, employees of the federal government fall under the harmonised general pension scheme (together with employees of the private sector, the self-employed and farmers). The new system is based on the principle that an income

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<sup>14</sup> According to the Ministry of Finance, the first stage of the reform running from 2000 till 2006 resulted in 7.4 billion euro of saving.

replacement for a person retiring at the age of 65 after 45 years of contributions amounts to 80% of the average of whole working life income. The harmonisation of the pension systems of the employees of the States and municipalities was to follow soon in order to keep the future outlays on pensions in check. However, even now, almost three years on, this harmonisation has not yet been completed. After the abolition of a “homogeneity principle” in 1999, the pension system for the employees of the sub-national authorities became more generous than for those of the federal level<sup>15</sup>. During the negotiations on the FAG 2008-2013, the States committed themselves to completing the long-awaited harmonisation by the end of 2009. However, the States are not expected to “copy” the rules governing the pensions for the federal government employees. They must, however, ensure that the reform of their pension system will result in savings equivalent to those made on the federal level. Such formulation of the goal of the reform does not seem to be very precise.

#### 2.4.2. *Health care system*

The Austrian health care system is organised in a fairly complex way. The social security system funds practising physicians. In terms of hospitals, the federal government sets out framework conditions, but the States are the real decision-makers, even though they provide less than half of the government outlays for hospitals (the rest comes from social insurance as well as from the federal and local governments). In running hospitals, the States and municipalities do not always pursue an exclusively health services provision agenda. There are also economic and political interests at stake, which make closing down of redundant hospitals literally impossible. Since different agents are responsible for the in-patient and out-patient services, there is no incentive to move workload from costly hospitals to practising physicians whose services are cheaper. The number of hospital stays in Austria is one of the highest among the OECD countries<sup>16</sup>. According to the federal audit court, hospital services worth more than 1% of GDP should be shifted from the hospital service to practising physicians<sup>17</sup>. According to the result of the negotiations, which accompanied those on the FAG, the States will receive from the federal government additional 100 million euro per year for the financing of hospitals. This is to be done with no strings attached, and therefore is perceived as a missed opportunity to exercise pressure on the States to make the hospital system more cost-efficient.

#### 2.4.3. *Education*

The financing of the education system is one of the most controversial issues. The federal government is responsible for the curriculum and funds the salaries of the teachers to a large extent. The latter, though, are formally employed by the States, which have far-reaching competences in terms of organisation of schooling. Such division of competences does not encourage effective allocation of resources. In fact, cross-country efficiency analyses show that Austria spends roughly the same amount on education as

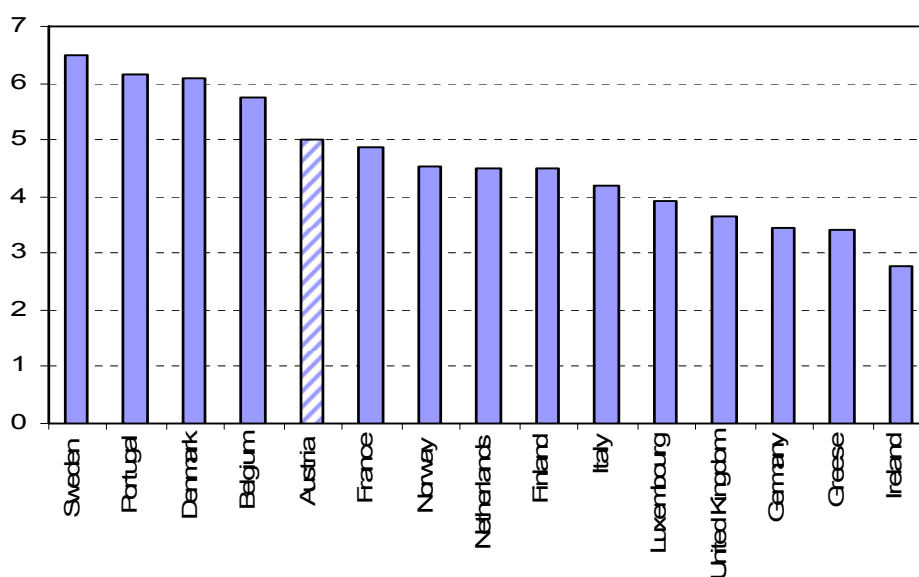
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<sup>15</sup> Grossmann, B., Hauth, E. (2007), *Verwaltungs- und Pensionsreformen im öffentlichen Dienst sowie Finanzierung des Krankenanstaltenwesens*, Staatsschuldenausschuss, Manzsche Verlags- und Universitätsbuchhandlung, Wien

<sup>17</sup> *Vorschläge des Rechnungshofes zur Verwaltungsreform und zum Bürokratieabbau*, Positionen Reihe 2007/1, August 2007

other economies (i.e. Finland), but the performance in PISA is relatively poor. In the past Austria could nevertheless enjoy low unemployment rates, in particular regarding youth unemployment. However, this picture has changed in recent years. The unemployment rate of population aged less than 25 increased to over 9% in 2006. This is mainly driven by the reluctance to adapt the education system to the labour market needs and in particular deficiencies in the integration of the second generation of immigrants. In November 2007 an expert group, appointed by the Minister of Education, put forward several proposals for reforms in the education system in their first interim report. However, the division of competences and consequently the controversial issue of financing remain unchanged.

**Figure 2: Spending on education as percentage of GDP**



*Source: OECD*

#### 2.4.4. Housing assistance scheme

The housing assistance scheme is not tackled under the FAG, but negotiations on its further financing always accompany the FAG negotiations. The scheme consists in earmarked funding (about 0.7% of GDP per year) that the federal government provides to the States in order to subsidise residential construction. In terms of social redistribution, the effectiveness of the measure is doubtful as only a small proportion of people with low-income own residential property. In practice, the measure subsidises the construction industry, diverting resources away from more productive allocations<sup>18</sup>. Therefore, there were proposals put forward to give up on the scheme. However, scrapping it was rejected during the latest FAG negotiations. The only positive result of the discussion was the introduction into the scheme of some incentives aimed at environmental protection.

<sup>18</sup> Fuentes, A. et al (2006), *Reforming federal fiscal relations in Austria*, OECD, Economic Department Working Papers no. 474



#### 2.4.5. *Social protection*

The provision of social assistance is divided between the federal and regional governments. The former funds and distributes unemployment insurance benefits. The latter is responsible for financing and administering of means-tested income support as well as of unemployment assistance given to people whose entitlement to unemployment insurance benefits has already expired. The involvement of two different administrations is inefficient both from the point of view of the fund providers (people claiming illegally assistance from two sources) and fund receivers (dealing with double bureaucracy). However, no proposals of shifting the responsibility for financing and administering of the social assistance have been agreed on during the latest FAG negotiations.

### **2.5. Conclusion**

The above-presented list of areas where serious reform should be contemplated is not exhaustive, but it shows that the need for change, and therefore the potential for savings, is substantial. Reforming its fiscal federal relations would help Austria to act on its long-standing promise of achieving a balanced budget over the cycle. Several ad-hoc working groups have been set up and have issued a number of recommendations how to reform federal fiscal relations in Austria. Political agreement on a comprehensive institutional overhaul should be facilitated by the large majority the present government enjoys in Parliament.

## **3. MACROECONOMIC OUTLOOK**

This section assesses the plausibility of the macroeconomic scenario (economic activity, labour market, costs and prices) underpinning the public finance projections of the programme. It also examines whether good or bad economic times in the sense of the Stability and Growth Pact prevail.

### **3.1. Economic activity**

According to the 2007 update of the stability programme<sup>19</sup>, real GDP growth is to decelerate from 3.4% in 2007 to about 2.5% of GDP in the remaining years of the programme period. Net exports' contribution to growth is expected to diminish significantly in 2008 and to recover thereafter. The profile of private consumption growth will remain quite flat, whereas a marked slowdown is expected in investment growth. The programme assumes that the output gap will turn positive in 2007 and will remain so until the end of the programme period.

Average real GDP growth during the update's period is higher almost by ½ pp. than that of the previous decade. It relies relatively less on net exports' contribution to growth and more on domestic demand than was the case in the past. In particular, the rate of investment growth is almost three times higher than that recorded in the previous decade (Annex 2).

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<sup>19</sup> The external outlook behind the programme's macroeconomic scenario is broadly in line with that in the Commission services' autumn 2007 forecast.

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

	2007		2008		2009		2010
	COM	SP	COM	SP	COM	SP	SP
Real GDP (% change)	3.3	3.4	2.7	2.4	2.4	2.5	2.5
Private consumption (% change)	1.7	1.9	1.9	2.1	2.1	2.3	2.2
Gross fixed capital formation (% change)	5.7	6.3	3.2	3.7	2.4	3.6	3.5
Exports of goods and services (% change)	7.2	8.3	6.5	6.0	5.9	6.0	5.6
Imports of goods and services (% change)	6.1	7.7	6.0	6.5	5.3	5.7	5.4
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	2.4	2.7	2.1	2.3	1.7	2.3	2.3
- Change in inventories	-0.2	-0.1	0.0	-0.1	0.0	-0.3	-0.2
- Net exports	1.0	0.8	0.7	0.1	0.7	0.5	0.5
Output gap <sup>1</sup>	0.4	0.4	0.8	0.4	0.8	0.5	0.5
Employment (% change)	1.4	1.9	0.8	1.1	0.7	0.9	0.9
Unemployment rate (%)	4.3	4.3	4.2	4.2	4.2	4.1	3.9
Labour productivity (% change)	1.6	1.5	1.8	1.3	1.8	1.5	1.5
HICP inflation (%)	1.9	1.9	1.9	2.0	1.8	2.0	2.0
GDP deflator (% change)	2.3	2.4	2.1	2.0	1.4	1.5	1.5
Comp. of employees (per head, % change)	2.4	2.7	2.8	3.0	2.6	2.7	2.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.6	3.5	5.2	3.7	5.3	3.7	3.7
<u>Note:</u>							
<sup>1</sup> In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.							
<u>Source:</u>							
Commission services' autumn 2007 economic forecasts (COM); Stability programme (SP)							

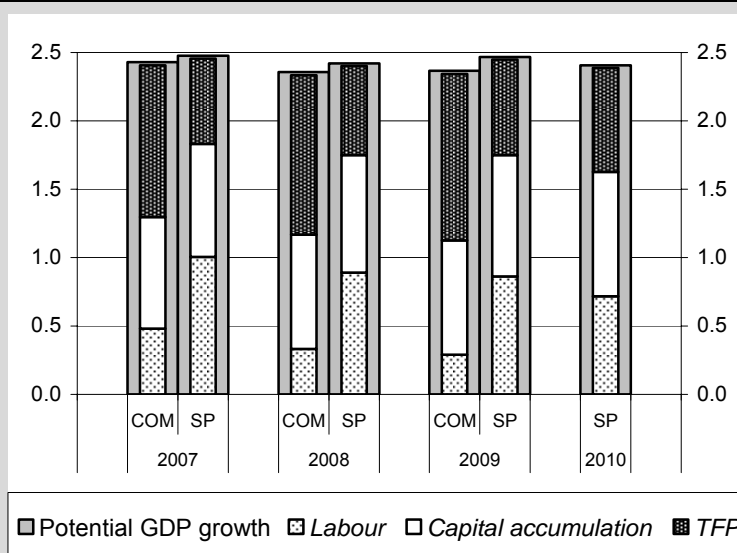
The programme's macroeconomic projections seem to be plausible. They are broadly in line with Commission services' autumn 2007 forecast for the period 2007-2009 and for the year 2010 with the average of the Commission services' estimate of potential output for 2007-2009. However, for 2009-2010 the programme projects a quite substantial negative growth contribution from inventories, which is a rather unusual assumption.

In terms of the composition, real GDP growth as presented in the programme seems to rely a bit less on the net exports' contribution than does the Commission services' forecast. The update foresees more favourable developments in investment activity. The programme's projections regarding private consumption growth are also marginally more optimistic than those of the Commission services (by 0.2 pp. in each year). This is the case also for growth of wages and salaries, with the small initial gap between the projections of the programme and the Commission services gradually closing over the update period.

### **Box 2: Potential growth and its determinants**

According to the Commission services' recalculations using the commonly agreed methodology based on the information provided in the programme, the potential output growth will remain close to 2.5% throughout the update period.

#### **Potential growth and its determinants**



The potential output projections assumed by the programme are broadly in line with real GDP growth in the last decade. They also agree with the potential output growth estimates according to the Commission services' autumn 2007 forecast. In terms of the composition of contributions, the programme and the Commission services' projections are similar when it comes to capital accumulation. However, the programme assigns much bigger contribution to labour than the Commission services' forecast does, with the latter relying more heavily on TFP contribution. The sizeable difference between the labour contribution is due to the programme's higher assumptions regarding growth both in employment and in total hours worked.

The programme's projection of the output gap in 2007, recalculated by the Commission services on the basis of the data provided in the programme using the commonly agreed methodology, is in line with that in the Commission services' autumn 2007 forecast. For the period 2008-2009, the projections of the output gap differ, with the programme implying less favourable cyclical conditions, illustrated by a smaller positive gap.

### 3.2. Labour market and cost and price developments

The programme foresees robust growth of employment, which will however decelerate over the update period. The projected growth is on average twice as high as in the previous decade. In comparison to the Commission services' forecast, the update's projections regarding employment growth are slightly more optimistic, with the gap between the two closing gradually towards the end of the update period. The programme also assumes a stronger growth in hours worked than the Commission services do.

According to the update, on average employment growth explains about 1/3 of the real GDP growth over the programme period, which is significantly higher in comparison to the projections of the Commission services. The difference is explained by the programme's higher assumptions concerning both growth in employment and in total hours worked (see Box 2). The programme's path for the development of the unemployment rate is consistent with the assumed cyclical conditions. The positive output gap is accompanied by a decline in the unemployment rate.

Given the latest developments in food and oil prices, the programme's projections for inflation could appear slightly optimistic. Inflation is expected to remain moderate (close to the 2% threshold) throughout the update period, as wage developments are in line with gains in productivity. In comparison to the developments in the previous decade, on

average inflation rate is expected to be somewhat higher during the programme period whereas labour productivity will remain unchanged.

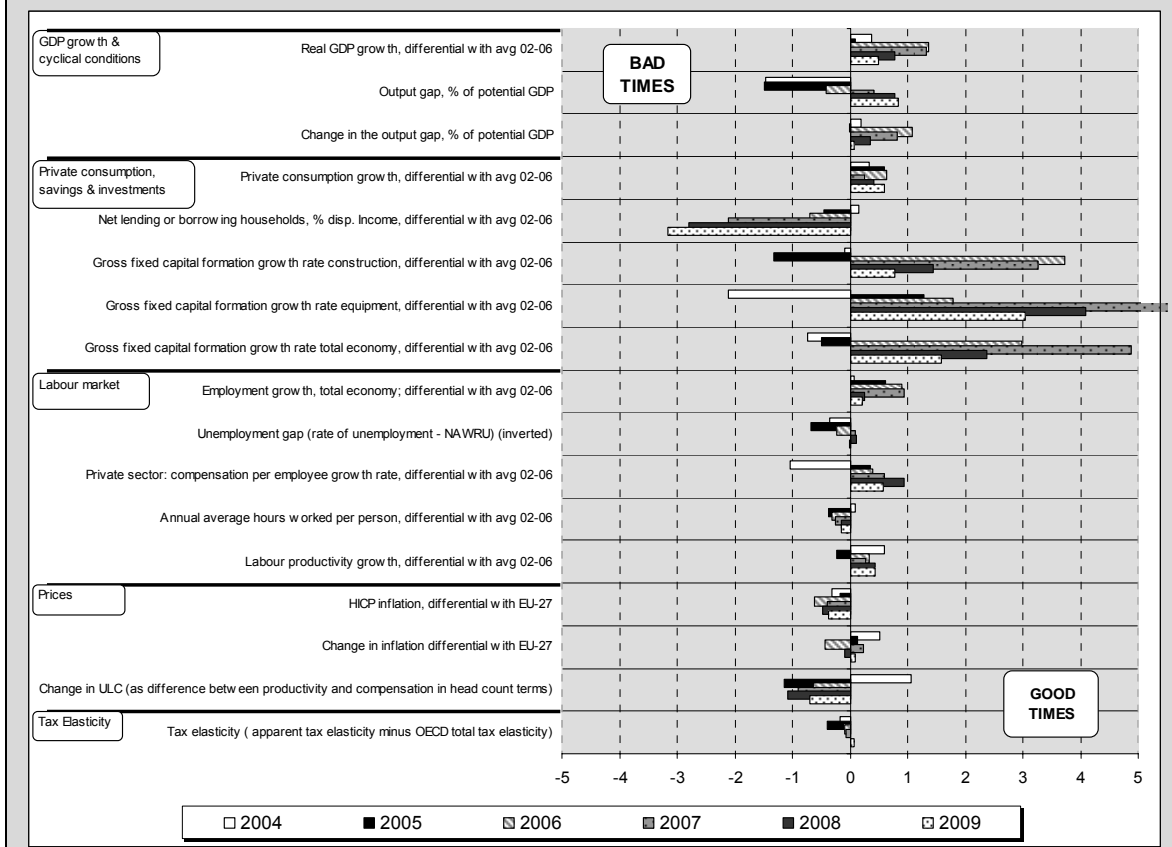
### Box 3: Good or bad economic times?

According to the code of conduct, the assessment of whether the economy is experiencing good or bad economic times starts from the output gap, but draws on an overall economic assessment, which should also take into account tax elasticities. The figure below presents a set of macroeconomic indicators drawn from the Commission services' autumn 2007 forecast. Overall, the economy seems to be in good economic times taking into account tax elasticities in the period 2007-2009.

The output gap is expected to turn positive in 2007 and stay so in 2008 and 2009. As illustrated by the graph, GDP growth will be driven by investment. Private consumption, even though sluggish, will grow faster than in the previous five years. The inflation rate is to remain below the euro area average in spite of compensation per head growing strongly compared to historical levels. Since labour productivity is also expected to remain high, unit labour cost should stay relatively low.

The apparent tax elasticity in the Commission services' autumn 2007 forecast remains close to the OECD ex-ante elasticity throughout the 2007-2009 period. The former is marginally lower than the latter in 2007 and 2008, but higher in 2009, indicating good times, in line with the developments of the output gap.

#### Good versus bad times



#### 4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2007 and the second presents the medium-term budgetary strategy in the new update. The third analyses the risks attached to the budgetary targets in the programme. The final part assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

##### 4.1. Budgetary implementation in 2007

Table 3 compares the 2007 revenue and expenditure targets (as a percentage of GDP) from the previous update of the stability programme with the results of the Commission services' autumn 2007 forecast. The difference between the revenue and expenditure targets for 2007 and the projected outcome is decomposed into a base effect, a GDP growth effect on the denominator and a revenue / expenditure growth effect<sup>20</sup>:

- The base effect captures the part of the difference that is due to the actual outcome for 2006 being different from what was projected in the previous update in the programme (either because the actual revenue / expenditure level in 2006 was different from the estimated outcome in the previous programme or because GDP turned out to be different from the scenario in the previous update of the programme). The base effect therefore also captures the effect of revisions to the GDP series.
- The GDP growth effect on the denominator captures the part of the difference that is related to current GDP growth projections for 2007 turning out higher or lower than anticipated in the previous update of the programme (therefore reducing / increasing the denominator of the revenue and expenditure ratio).
- The revenue / expenditure growth effect captures the part of the difference related to the revenue / expenditure growth rate in 2007 turning out to be higher or lower than targeted in the previous update of the programme. This would typically be due to GDP developments different from those expected in the previous update of the programme, or as a result of apparent tax elasticities different from the ex ante tax elasticities (or both).

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<sup>20</sup> A fourth, residual component is usually small, except if there are very large differences between the autumn forecast and the target (the full mathematical decomposition is in the methodological paper mentioned above).

**Table 3: Budgetary implementation in 2007**

	2006		2007	
	Planned	Outcome	Planned	Outcome
	SP Mar 2007	COM	SP Mar 2007	COM
Revenue (% of GDP)	48.0	47.8	47.6	47.5
Expenditure (% of GDP)	49.2	49.2	48.7	48.4
Government balance (% of GDP)	-1.1	-1.4	-0.9	-0.8
Nominal GDP growth (%)			4.4	5.6
Nominal revenue growth (%)			3.7	4.9
Nominal expenditure growth (%)			3.3	3.8
<b>Revenue surprise compared to target (% of GDP)</b>				<b>-0.1</b>
<i>Of which</i> <sup>1</sup> : 1. Base effect				-0.1
2. GDP growth effect on the denominator				-0.5
3. Revenue growth effect				0.5
<i>Of which: due to a marginal elasticity of total revenue w.r.t. GDP larger than 1</i> <sup>2</sup>				0.0
<b>Expenditure surprise compared to target (% of GDP)</b>				<b>-0.3</b>
<i>Of which</i> <sup>1</sup> : 1. Base effect				0.0
2. GDP growth effect on the denominator				-0.5
3. Expenditure growth effect				0.2
<b>Government balance surprise compared to target (% of GDP)</b>				<b>0.1</b>
<i>Of which</i> : 1. Base effect				-0.1
2. GDP growth effect on the denominator				0.0
3. Revenue / expenditure growth effect				0.3
<u>Notes:</u>				
<sup>1</sup> A positive base effect points to a higher-than-anticipated outcome of the revenue / expenditure ratio in 2006. A positive GDP growth effect (on the denominator) indicates lower-than-anticipated economic growth in 2007. A positive revenue / expenditure growth effect points to higher-than-anticipated revenue / expenditure growth in 2007. The three components may not add up to the total because of a residual component, which is generally small.				
<sup>2</sup> Equal to (2)+(3). A positive sign means that the marginal elasticity of revenue with respect to GDP exceeds one.				
<u>Source:</u> Commission services				

The previous update of the programme foresaw a general government deficit of 0.9% of GDP in 2007. According to the Commission services' forecast the deficit will be lower by 0.1 pp. and the new update targets an even smaller deficit of 0.7% of GDP. Taking into account new tax revenue data, the latter appears to be most plausible.

As illustrated in Table 3, in 2007 both nominal revenue and expenditure were growing stronger than planned. The positive surprise in terms of general government balance is a result of revenue outgrowing the expectations by more than it is the case for expenditure. In particular, proceeds from wage and corporate tax, as well as capital yields taxes are responsible for the higher-than-planned revenue. The expenditure overrun can be explained to a large extent by higher-than-expected spending by the States on health and long-term care (in particular, in Upper Austria and Styria). A part of the slippage is due to the higher-than-foreseen spending on the military equipment.

It must be also noted that the positive surprise on the revenue side more than compensated for the negative base effect of the 2006 deficit. It turned out only in September 2007 that the general government deficit finally was higher by 0.3 pp. than the previously thought 1.1% of GDP (even though still lower than the initially targeted 1.7% of GDP).

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

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

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

The programme sets a goal of achieving a balanced budget in structural terms (Austria's MTO) by 2010. This formulation replaces the one of the previous updates which declared a goal of "achieving a balanced budget over the business cycle". This goal is a part of a three-pronged budgetary strategy, which also envisages promoting investments in the field of R&D, infrastructure, education and universities as well as social protection for more growth and employment and foresees implementing structural reforms in the field of public administration, competition policy and labour market in order to achieve savings for future tax reforms.

The new programme announces 2010 as the target year for achieving the MTO. Compared with the previous update, which envisaged that the MTO would be nearly reached in 2009, the planned adjustment is slightly even more backloaded despite a more favourable growth performance in 2007. The programme foresees a general government deficit of 0.7% of GDP gradually turning into a surplus of 0.4% of GDP in 2010. Consolidation of public finances is planned to peak in the last two years of the update period.

**Table 4: Evolution of budgetary targets in successive programmes**

		2006	2007	2008	2009	2010
General government balance (% of GDP)	<b>SP Nov 2007</b>	<b>-1.4</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.2</b>	<b>0.4</b>
	<i>SP Mar 2007</i>	<i>-1.1</i>	<i>-0.9</i>	<i>-0.7</i>	<i>-0.2</i>	<i>0.4</i>
	COM Nov 2007	-1.4	-0.8	-0.7	-0.4	n.a.
General government expenditure (% of GDP)	<b>SP Nov 2007</b>	<b>49.3</b>	<b>48.3</b>	<b>48.1</b>	<b>47.7</b>	<b>47.2</b>
	<i>SP Mar 2007</i>	<i>49.2</i>	<i>48.7</i>	<i>48.3</i>	<i>47.5</i>	<i>46.9</i>
	COM Nov 2007	49.2	48.4	48.0	47.8	n.a.
General government revenue (% of GDP)	<b>SP Nov 2007</b>	<b>47.8</b>	<b>47.4</b>	<b>47.5</b>	<b>47.3</b>	<b>47.4</b>
	<i>SP Mar 2007</i>	<i>48.0</i>	<i>47.6</i>	<i>47.4</i>	<i>47.2</i>	<i>47.1</i>
	COM Nov 2007	47.8	47.5	47.3	47.4	n.a.
Structural balance <sup>1</sup> (% of GDP)	<b>SP Nov 2007</b>	<b>-1.2</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.4</b>	<b>0.1</b>
	<i>SP Mar 2007</i>	<i>-1.0</i>	<i>-0.8</i>	<i>-0.4</i>	<i>-0.2</i>	<i>0.2</i>
	COM Nov 2007	-1.2	-1.0	-1.0	-0.8	n.a.
Real GDP (% change)	<b>SP Nov 2007</b>	<b>3.3</b>	<b>3.4</b>	<b>2.4</b>	<b>2.5</b>	<b>2.5</b>
	<i>SP Mar 2007</i>	<i>3.1</i>	<i>2.7</i>	<i>2.3</i>	<i>2.5</i>	<i>2.6</i>
	COM Nov 2007	3.3	3.3	2.7	2.4	n.a.
<u>Note:</u>						
<sup>1</sup> Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. According to the most recent programme one-off and other temporary measures are 0.2% of GDP in 2007 and 2008 and 0.1% of GDP in 2009; all deficit-increasing. There are no one-off and other temporary measures in the Commission services' autumn forecast.						
<u>Source:</u>						
<i>Stability programmes (SP); Commission services' autumn 2007 economic forecasts (COM)</i>						

For the whole update period, the programme assumes consolidation by 1.1 percentage points of GDP and 0.9 percentage points of GDP in terms of headline balance and primary balance, respectively. As illustrated in Table 4: , the structural balance resulting from the Commission services' calculations on the basis of the programme according to the commonly agreed methodology is planned to improve from a deficit of 0.7% of GDP in 2007 to a surplus of 0.1% of GDP in 2010. This cumulative consolidation effort of 0.8% of GDP is backloaded, with the most significant improvement planned to take place in the last year (by 0.5% of GDP).

The above-presented adjustment takes into account one-offs as identified in the programme. The profile of the structural adjustment over the update period will 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 2007-2010 period amounts to 1%, so it is actually higher than if one counts the purchase of the military equipment as a one-off.

Throughout the programme period, the fiscal stance is considered to be broadly neutral as the structural balance is planned to improve by less than or equal to 1/2% of GDP per year.



**Table 5: Composition of the budgetary adjustment**

(% of GDP)	2006	2007	2008	2009	2010	Change: 2010-2007
<b>Revenue</b>	<b>47.8</b>	<b>47.4</b>	<b>47.5</b>	<b>47.3</b>	<b>47.4</b>	<b>0.0</b>
<i>of which:</i>						
- Taxes on production and imports	14.0	13.7	13.6	13.6	13.5	<b>-0.2</b>
- Current taxes on income, wealth, etc.	13.1	13.1	13.2	13.3	13.3	<b>0.3</b>
- Social contributions	16.0	15.8	15.9	15.8	15.8	<b>0.0</b>
- Other (residual)	4.8	4.8	4.7	4.7	4.8	<b>0.0</b>
<b>Expenditure</b>	<b>49.3</b>	<b>48.3</b>	<b>48.1</b>	<b>47.7</b>	<b>47.2</b>	<b>-1.1</b>
<i>of which:</i>						
- Primary expenditure	46.5	45.6	45.5	45.1	44.7	<b>-0.9</b>
<i>of which:</i>						
Compensation of employees	9.3	9.1	9.1	9.0	8.9	<b>-0.2</b>
Intermediate consumption	4.5	4.6	4.7	4.4	4.3	<b>-0.3</b>
Social payments	23.4	23.0	23.0	22.9	22.8	<b>-0.1</b>
Subsidies	3.1	2.9	2.9	2.9	2.9	<b>0.0</b>
Gross fixed capital formation	1.0	1.1	1.1	1.1	1.0	<b>0.0</b>
Other (residual)	5.3	4.9	4.9	4.9	4.7	<b>-0.3</b>
- Interest expenditure	2.9	2.7	2.6	2.5	2.5	<b>-0.2</b>
<b>General government balance (GGB)</b>	<b>-1.4</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.2</b>	<b>0.4</b>	<b>1.1</b>
<b>Primary balance</b>	<b>1.5</b>	<b>2.0</b>	<b>2.1</b>	<b>2.3</b>	<b>2.8</b>	<b>0.9</b>
One-off and other temporary measures	0.0	-0.2	-0.2	-0.1	0.0	<b>0.2</b>
<b>GGB excl. one-offs</b>	<b>-1.4</b>	<b>-0.5</b>	<b>-0.4</b>	<b>-0.1</b>	<b>0.4</b>	<b>0.9</b>
Output gap <sup>1</sup>	-0.5	0.4	0.4	0.5	0.5	<b>0.1</b>
Cyclically-adjusted balance <sup>1</sup>	-1.2	-0.9	-0.8	-0.4	0.1	<b>1.1</b>
<b>Structural balance<sup>2</sup></b>	<b>-1.2</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.4</b>	<b>0.1</b>	<b>0.9</b>
<i>Change in structural balance</i>		0.4	0.2	0.2	0.5	
Structural primary balance <sup>2</sup>	1.7	2.0	2.1	2.2	2.6	<b>0.6</b>
<i>Change in structural primary balance</i>		0.3	0.1	0.1	0.4	
<b>Notes:</b>						
<sup>1</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance as recalculated by Commission services on the basis of the information in the programme.						
<sup>2</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.						
<b>Source:</b>						
<i>Stability programme; Commission services' calculations</i>						

#### 4.2.2. The composition of the budgetary adjustment

The programme assumes that the revenue/GDP ratio will remain more or less unchanged throughout the update period. Therefore, the planned consolidation effort will concentrate on the expenditure side and is expected to amount to 1.1 pp. Like in the previous update, interest expenditure is projected to decline by 0.2 pp. between 2007 and 2010. Primary expenditure is supposed to go down by 0.9 pp. One third of that planned adjustment falls into the category “other expenditure“, which is not explained in detail. Another third of the expenditure adjustment is evenly distributed between compensation of employees and social payments.

The remaining third concerns “intermediate consumption”. This expenditure category is projected to increase slightly in 2008 and to decline in 2009. This is mainly explained by the additional expenditure for military equipment, which will amount to about 1.4 billion euro (about 0.5% of GDP) in the period from 2007 to 2009, with the peak in 2008. This figure includes other related costs, such as of procurement. In national accounts, military expenditure is recorded as intermediate consumption at the time of delivery<sup>21</sup>. The purchase agreement currently foresees buying of 15 Eurofighters (18 in the previous update), 5 of which were delivered in 2007 and the rest is scheduled to arrive in 2008 and 2009. The programme treats this expenditure as a one-off measure. The Commission services do not consider the expenditure on military equipment as a one-off.

The adjustment in 2008 is underpinned with measures broadly presented in the programme. However, for the years 2009 and 2010 the improvement in the cyclically-adjusted balance is not fully explained by the update’s measures.

**Box 4: The budget for 2008**

The federal budget for 2008 was presented (together with that for 2007) by the new government on 29 March 2007. The parliament adopted the twin budget on 3 May 2007. The budget for 2008 targets a deficit of 0.7% of GDP.

Revenue will benefit from the increase in fuel duties introduced in mid-2007. In terms of spending, like in 2007, the budget will be burdened with the expenditure on military aircraft amounting to about 0.2% of GDP. Additional cost of about 0.1% of GDP will be incurred because of the introduction of two new variants of the childcare allowance, whereby parents will be allowed to opt for higher monthly payments, but for a shorter period of time than previously. The continued reform of public administration is expected to result in saving of around 0.1% of GDP.

**Main measures in the budget for 2008**

Revenue measures*	Expenditure measures**
○ Increase in fuel duties (0.1% of GDP)	○ New childcare allowance (0.1% of GDP)
	○ Public administration reform (-0.1% of GDP)

\* Estimated impact on general government revenues.  
 \*\* Estimated impact on general government expenditure.

*Sources:* Commission services and the November 2007 update of the stability programme.

**4.3. Risk assessment**

This section discusses the plausibility of the programme’s budgetary projections by analysing various risk factors. For the period until 2009, Table 6: compares the detailed revenue and expenditure projections in the Commission services’ autumn 2007 forecast, which are derived under a no-policy change scenario, with those in the updated programme.

<sup>21</sup> 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\\_2006-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/DEFICIT_DEBT_2006/EN/DEFICIT_DEBT_2006-EN.PDF)

**Table 6: Comparison of budgetary developments and projections**

(% of GDP)	2006	2007		2008		2009		2010
	COM	COM	SP	COM	SP	COM <sup>1</sup>	SP	SP
<b>Revenue</b>	<b>47.8</b>	<b>47.5</b>	<b>47.4</b>	<b>47.3</b>	<b>47.5</b>	<b>47.4</b>	<b>47.3</b>	<b>47.4</b>
<i>of which:</i>								
- Taxes on production and imports	14.0	13.7	13.7	13.6	13.6	13.6	13.6	13.5
- Current taxes on income, wealth, etc.	13.1	13.2	13.1	13.3	13.2	13.4	13.3	13.3
- Social contributions	16.0	15.8	15.8	15.8	15.9	15.8	15.8	15.8
- Other (residual)	4.8	4.8	4.8	4.7	4.7	4.7	4.7	4.8
<b>Expenditure</b>	<b>49.3</b>	<b>48.5</b>	<b>48.3</b>	<b>48.1</b>	<b>48.1</b>	<b>47.9</b>	<b>47.7</b>	<b>47.2</b>
<i>of which:</i>								
- Primary expenditure	46.5	45.8	45.6	45.6	45.5	45.4	45.1	44.7
<i>of which:</i>								
Compensation of employees	9.3	9.1	9.1	9.0	9.1	9.0	9.0	8.9
Intermediate consumption	4.5	4.6	4.6	4.7	4.7	4.4	4.4	4.3
Social payments	23.4	23.0	23.0	23.0	23.0	23.0	22.9	22.8
Subsidies	3.1	2.9	2.9	2.9	2.9	3.0	2.9	2.9
Gross fixed capital formation	1.1	1.0	1.1	1.0	1.1	1.0	1.1	1.0
Other (residual)	5.2	5.1	4.9	4.9	4.9	5.0	4.9	4.7
- Interest expenditure	2.9	2.7	2.7	2.6	2.6	2.5	2.5	2.5
<b>General government balance (GGB)</b>	<b>-1.4</b>	<b>-0.8</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.4</b>	<b>-0.2</b>	<b>0.4</b>
<b>Primary balance</b>	<b>1.4</b>	<b>1.7</b>	<b>2.0</b>	<b>1.8</b>	<b>2.1</b>	<b>2.0</b>	<b>2.3</b>	<b>2.8</b>
One-off and other temporary measures	0.0	0.0	-0.2	0.0	-0.2	0.0	-0.1	0.0
<b>GGB excl. one-offs</b>	<b>-1.4</b>	<b>-0.8</b>	<b>-0.5</b>	<b>-0.7</b>	<b>-0.4</b>	<b>-0.4</b>	<b>-0.1</b>	<b>0.4</b>
Output gap <sup>2</sup>	-0.4	0.4	0.4	0.8	0.4	0.8	0.5	0.5
Cyclically-adjusted balance <sup>2</sup>	-1.2	-1.0	-0.9	-1.0	-0.8	-0.8	-0.4	0.1
<b>Structural balance<sup>3</sup></b>	<b>-1.2</b>	<b>-1.0</b>	<b>-0.7</b>	<b>-1.0</b>	<b>-0.6</b>	<b>-0.8</b>	<b>-0.4</b>	<b>0.1</b>
<i>Change in structural balance</i>		<i>0.1</i>	<i>0.4</i>	<i>0.0</i>	<i>0.2</i>	<i>0.3</i>	<i>0.2</i>	<i>0.5</i>
Structural primary balance <sup>3</sup>	1.6	1.5	2.0	1.4	2.1	1.6	2.2	2.6
<i>Change in structural primary balance</i>		<i>0.0</i>	<i>0.3</i>	<i>-0.1</i>	<i>0.1</i>	<i>0.2</i>	<i>0.1</i>	<i>0.4</i>
<u>Notes:</u>								
<sup>1</sup> On a no-policy-change basis.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<u>Source:</u>								
<i>Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations</i>								

As mentioned above in Section 3.1, the macroeconomic scenario set out by the update is broadly plausible. However, the Commission services' projections are slightly less "tax-rich" as GDP growth relies more heavily on the contribution of net exports than the update does.

The budgetary path projected in the update appears plausible for 2007 and 2008. It should be noted that the higher expenditure ratio projected for 2007 by the Commission services as compared with the programme is partly a result of slightly lower nominal GDP growth projected by the Commission services. The decline of expenditure as percentage of GDP is planned to accelerate towards the end of the update's period. While

it is supposed to go down only by 0.2 pp. between 2007 and 2008, it is to adjust by about 0.5 pp. per year in the remaining two years.

As previously stated, one third of the planned adjustment in primary expenditure falls into the category “other expenditure”, which is not explained in detail. This category 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. If the planned additional spending on R&D is given as investment grants, it would constitute an increase in this category. Moreover, 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 documented in the update, doubts remain over the projected decrease as a percentage of GDP in this sub-category.

The programme presents a table with quantification of the measures aimed at helping the consolidation of public finances. For 2008, the measures explain quite well the foreseen adjustment in the cyclically-adjusted deficit. However, for 2009 and 2010 they point only to roughly half of the planned adjustment. Moreover, the impact of some of the measures presented in the table does not seem to be entirely convincing. For example, looking at the 2007 revenue from fuel tax up to the end of October might suggest that the increase in proceeds might not materialise necessarily to the planned degree. The quantification of saving due to declining unemployment rate does not seem consistent. The unemployment rate is expected to decline gradually between 2007 and 2010, whereas the savings accrued by that development seem to be changing quite abruptly from one year to another. Finally, savings from the reform of the public administration both at the level of the federal government as well as the sub-national ones are not specified and heavily backloaded.

The programme mentions in passing a tax reform announced for 2010. The only information provided is that the reform will consist of tax cuts. The budgetary impact of the foreseen reform is not included in the targets for 2010 in the stability programme. The update does not explain how this envisaged reform is supposed to square with the foreseen improvement in the government position in 2010. The future reform is taking more and more space in the public debate and according to a recent statement by the Minister of Finance these tax cuts are “an absolute priority” for the current government. Details of the reform are not known yet, but the government coalition partners have agreed that the tax cuts would amount to about 1.1% of GDP.

Since the inception of the Austrian Stability Pact (see Section 2 for details) in 1999, the regional and local governments always closed their budgets with surpluses or in balance, which had a mitigating effect on perennial deficits incurred by the federal government. This changed in 2006. It turned out only in September 2007 that in the previous year, the regional government balance amounted to a 0.1% of GDP deficit. According to the update, that was a result of one-off measures (in the interpretation of the Austrian Stability Pact, but contrary to Eurostat's interpretation), such as transactions concerning Bank Burgenland, restructuring of hospitals in Lower Austria, higher spending due to floods in Vorarlberg and Tyrol, and allowances to hospitals in Styria. The consolidation of public finances as presented in the programme will continue to depend strongly on the positive contribution of the sub-national governments. In view of the past experience

such one-off adjustments like those that occurred in 2006 cannot be excluded in the future. Indeed, according to a press report<sup>22</sup> the preliminary data for 2007 show that yet again the States in total have not respected their stability contribution foreseen by the Austrian Stability Pact.

Austria has a reasonably good track record in terms of meeting the deficit target in the current year by matching slight expenditure overruns with positive revenue surprises. 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 positive. This could change in the future with the introduction of the medium-term budgetary framework (see Section 6). It should be stressed, though, that only the federal government will adopt the new framework.

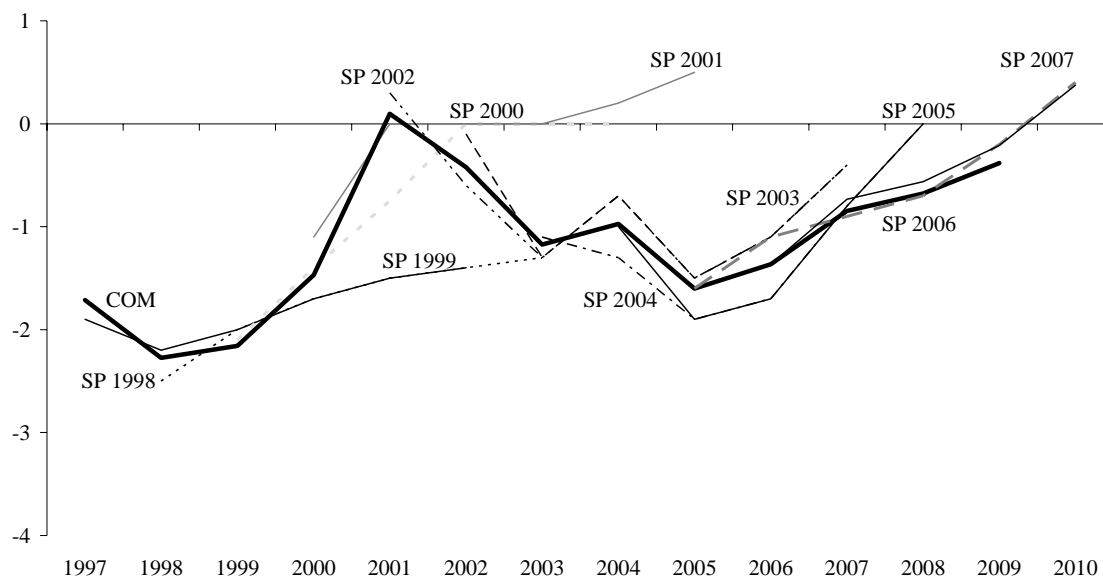
In sum, the budgetary projections seem plausible for 2007 and 2008. Beyond that, outcomes may be worse than targeted in the programme as there is a risk that measures necessary to underpin the envisaged expenditure restraint are not adopted or rigorously implemented, also in view of past experience.

**Table 7: Assessment of tax projections**

	2008			2009			2010
	SP	COM	OECD <sup>3</sup>	SP	COM <sup>1</sup>	OECD <sup>3</sup>	SP
Change in tax-to-GDP ratio (total taxes)	0.1	-0.1	-0.1	-0.1	0.1	-0.1	0.0
Difference (SP – COM)	0.2		/	-0.2		/	/
<i>of which<sup>2</sup>:</i>							
- discretionary and elasticity component	-0.1		/	-0.2		/	/
- composition component	0.4		/	0.1		/	/
Difference (COM - OECD)	/	0.0		/	0.1		/
<i>of which<sup>2</sup>:</i>							
- discretionary and elasticity component	/	-0.2		/	-0.2		/
- composition component	/	0.2		/	0.4		/
p.m.: Elasticity to GDP	1.1	1.0	1.0	0.9	1.0	1.0	1.0
<b>Notes:</b>							
<sup>1</sup> On a no-policy change basis.							
<sup>2</sup> 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 and variations of taxable income that do not necessarily move in line with GDP, e.g. capital gains. The two components may not add up to the total difference because of a residual component, which is generally small.							
<sup>3</sup> OECD ex-ante elasticity relative to GDP.							
<b>Source:</b>							
Commission services' autumn 2007 economic forecasts (COM); Stability programme (SP); Commission services' calculations; OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434).							

<sup>22</sup> *Bundeländer lassen wieder aus* in Kurier, 10 January 2008

**Figure 3: Government balance projections in successive programmes (% of GDP)**



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

#### **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 and, second, the final assessment also taking into account risks.

**Table 8: Overview of compliance with the Stability and Growth Pact**

	<b>Based on programme<sup>3</sup></b> (with the targets taken at face value)	<b>Assessment</b> (taking into account risks to the targets)
a. Safety margin against breaching 3% of GDP deficit limit <sup>1</sup>	throughout programme period	throughout programme period
b. Achievement of the MTO	In 2010	possibly not within programme period
c. Adjustment towards MTO in line with the Pact <sup>2</sup> ?	is insufficient and should be strengthened significantly in 2008	is insufficient and should be strengthened significantly
<p><u>Notes:</u>  <sup>1</sup>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 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.  <sup>2</sup>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.  <sup>3</sup>Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.</p> <p><u>Source:</u>  <i>Commission services</i></p>		

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 update period.

Given the projected structural surplus of 0.1%<sup>23</sup> of GDP in 2010, the MTO (a balanced position in structural terms) will be achieved in that year according to the programme. However, in view of the above-presented risk assessment, in particular for the outer years, the MTO might not be reached by the end of the programme period.

The programme projects a backloaded structural adjustment of 1 percentage point of GDP in cumulative terms between 2007 and 2010. On average, this implies an adjustment of ⅓ percentage point of GDP per year. If one treated the additional expenditure for military equipment as a one-off measure (which the programme does, but the Commission services do not), the cumulative adjustment would be even lower (0.8% of GDP). Overall, the pace of 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. Given that the output gap is projected to be positive throughout the programme period, and the economy thus in “good times”, and that the interest burden is expected to decline, the structural adjustment should be much stronger than proposed in the update. The structural deficit in 2007 is expected to amount to 0.9% of GDP. Thus, if the structural adjustment were in line with the 0.5% of GDP benchmark improvement provided for in the Pact (or a bit stronger in view of the good times), the MTO could still be reached in 2009.

<sup>23</sup> Commission services’ calculation on the basis of the information in the programme.

## 5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

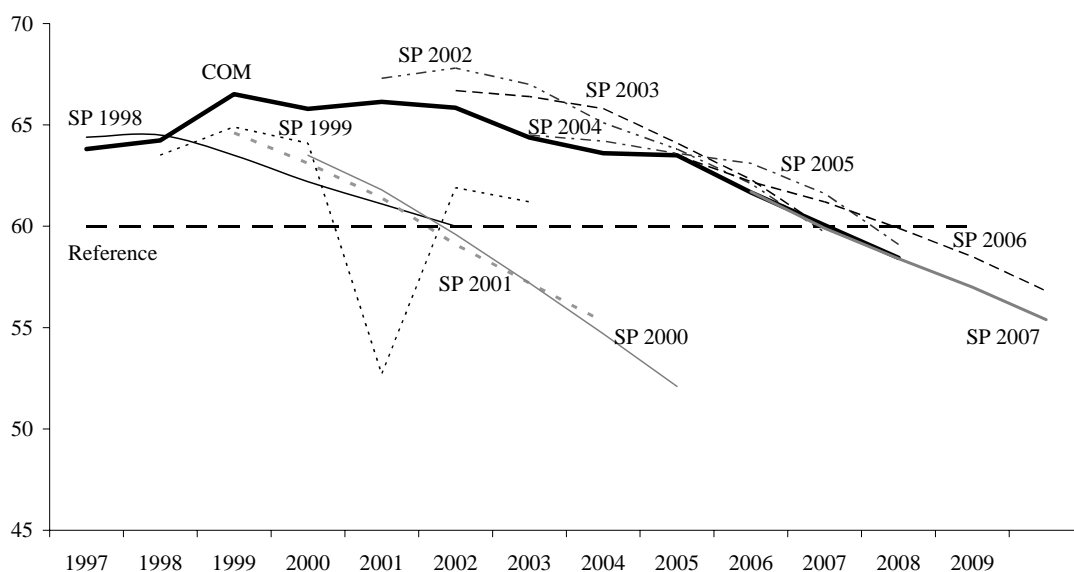
### 5.1. Recent debt developments and medium-term prospects

#### 5.1.1. Debt projections in the programme

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 of nominal GDP growth. The reduction in the debt ratio has been tempered by a (small) positive stock-flow adjustment which reflect mainly accumulation of financial assets.

Given that in 2007 the general government deficit is expected to turn out slightly lower than initially planned and that nominal GDP will most probably turn higher than forecast earlier, the general government debt ratio is projected to go down to 59.9% of GDP, i.e. will be lower than the 61.2% put forward in the previous update. Thereafter, both the update and the Commission services' forecast foresee continuous decline in the debt/GDP ratio.

**Figure 4: Debt projections in successive programmes (% of GDP)**



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



**Table 9: Debt dynamics**

(% of GDP)	average 2002-05	2006	2007		2008		2009		2010
			COM	SP	COM	SP	COM	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>64.4</b>	<b>61.7</b>	<b>60.0</b>	<b>59.9</b>	<b>58.4</b>	<b>58.4</b>	<b>57.2</b>	<b>57.0</b>	<b>55.4</b>
Change in the ratio	-0.6	-1.7	-1.6	-1.8	-1.6	-1.5	-1.2	-1.4	-1.6
<i>Contributions<sup>2</sup>:</i>									
<b>Primary balance</b>	<b>-1.7</b>	<b>-1.4</b>	<b>-1.7</b>	<b>-2.0</b>	<b>-1.8</b>	<b>-2.1</b>	<b>-2.0</b>	<b>-2.3</b>	<b>-2.8</b>
<b>“Snow-ball” effect</b>	<b>0.9</b>	<b>-0.3</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.3</b>	<b>0.1</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>
<i>Of which:</i>									
Interest expenditure	2.9	2.7	2.6	2.7	2.5	2.6	2.4	2.5	2.5
Growth effect	-1.0	-2.0	-1.9	-2.0	-1.6	-1.4	-1.4	-1.4	-1.4
Inflation effect	-1.0	-1.1	-1.3	-1.3	-1.2	-1.1	-0.8	-0.8	-0.8
<b>Stock-flow adjustment</b>	<b>0.2</b>	<b>0.0</b>	<b>0.8</b>	<b>0.8</b>	<b>0.5</b>	<b>0.5</b>	<b>0.6</b>	<b>0.6</b>	<b>1.0</b>
<i>Of which:</i>									
Cash/accruals diff.	0.0	-0.2		n.a.		n.a.		n.a.	n.a.
Acc. financial assets	0.4	0.4		n.a.		n.a.		n.a.	n.a.
<i>Privatisation</i>	<i>-0.1</i>	<i>0.0</i>		<i>n.a.</i>		<i>n.a.</i>		<i>n.a.</i>	<i>n.a.</i>
Val. effect & residual	-0.2	-0.2		n.a.		n.a.		n.a.	n.a.

Notes:  
<sup>1</sup>End of period.  
<sup>2</sup>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.

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

### 5.1.2. Assessment

Both the programme and the Commission services' autumn 2007 forecast foresee a continuous decline in the debt ratio. In 2007, the ratio is expected to fall down to just below the 60% of GDP threshold, first time since 1992. The risks to the projected evolution of the debt ratio appear to be broadly balanced, with on the one hand potentially higher-than-targeted deficits endangering adherence to the adjustment path presented in the programme, but on the other hand, nominal GDP possibly turning out higher than foreseen due to higher inflation.

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

This section analyses the long-term sustainability of public finances. It uses long-term projections of age-related expenditures to calculate sustainability gap indicators and make long-term government debt projections so as to assess the sustainability challenge the country concerned is facing.

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

Table 10 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 and property income received by general government according to an agreed methodology.<sup>24</sup> Non age-related primary expenditure and primary revenue is assumed to remain constant as a share of GDP.

**Table 10: Long-term age-related expenditure: main projections**

(% of GDP)	2004	2010	2020	2030	2040	2050	Change up to 50
<b>Total age-related spending</b>	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
<b>Property income received</b>	1.4	1.3	1.2	1.0	0.9	0.8	-0.6

*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 pp. 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 pp. of GDP, a similar increase to the EU average. For long-term care, an increase of 0.9 pp. of GDP is projected, slightly above the EU average. Under the hypothesis of no stock flow adjustment assumed in the long-term debt projections, property income received by the general government should decrease over the long-term by 0.6 pp. of GDP, somewhat higher than the EU average.

**Table 11: Sustainability indicators and the required primary balance**

Value	2007 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
Value	-0.1	0.3	2.5	-0.6	-0.3	2.5
<i>of which:</i>						
Initial budgetary position (IBP)	-1.0	-0.8	-	-1.5	-1.3	-
Debt requirement in 2050 (DR)	-0.1	-	-	-0.1	-	-
Long-term change in the primary balance (LTC)	1.0	1.1	-	1.0	1.1	-

*Source: Commission services.*

Based on the long-term budgetary projections, sustainability indicators can be calculated. Table 11 shows the sustainability indicators for the two scenarios; the 2007 scenario assumes that the structural primary balance in 2007 is unchanged for the rest of the programme period and the programme scenario assumes that the programme's budgetary plans are fully attained.

In the "2007 scenario", the sustainability gap (S2) which satisfies the intertemporal budget constraint would be 0.3 pp. of GDP.<sup>25</sup> The indicator is slightly higher than in last

<sup>24</sup> See the accompanying "methodological paper" for a description of the property income projections.

<sup>25</sup> The sustainability gap (S1) that assures reaching the debt ratio of 60% of GDP by 2050 would be - 0.1% of GDP.

year's assessment by around 0.4 pp. of GDP, essentially due to the inclusion of property income projections in the calculations of the sustainability indicator.

The favourable initial budgetary position with a structural primary balance of 2.0% of GDP contributes to the reduction of gross debt and the accumulation of financial assets. According to both sustainability gaps, the long-term budgetary impact of ageing is very small in particular thanks to the comprehensive pension reform enacted in recent years.

The programme plans a structural primary budgetary consolidation of ½ pp. of GDP between 2007 and 2010. If achieved, such a consolidation would reduce risks to long-term sustainability of public finances by eliminating the S2 sustainability gap ("programme scenario"). The difference between the initial budgetary position in the '2007 scenario' and the 'programme scenario' illustrates how the full respect of the stability programme targets, would contribute to tackling the budgetary challenges raised by the demographic developments.

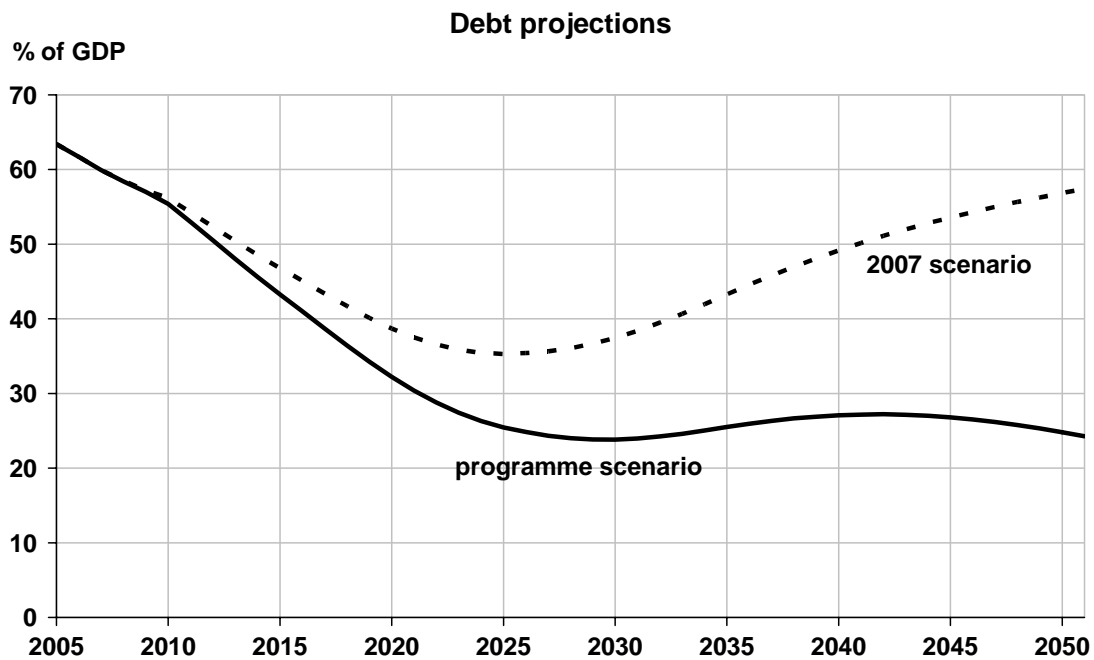
The required primary balance (RPB) is around 2.5% of GDP, close to the structural primary balance in the last year of the programme's period.

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 the sustainability indicators. The long-term projections for government debt under the two scenarios are shown in Figure 6. According to both scenarios, the debt, which is in 2007 at 59.9% of GDP, would remain below the 60% reference value over the projection period.<sup>26</sup>

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<sup>26</sup> 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 5: Long-term projections for the government debt ratio**



*Source: Commission services*

#### 5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant factors are taken into account, which in addition allow to better appreciate where the main risks to sustainability are likely to stem from.

First, the sustainability indicators are calculated on the basis of the long-term budgetary projections of the Ageing Report. The update of the programme point to slightly more dynamic pension expenditure over the long-term, including notably the 2007 parametric change in the pension scheme which, during a transition period, reduces the reduction ('Abschläge') for early retirement from 4.2% to 2.1%.<sup>27</sup> This increases the sustainability indicator by 0.3 p.p. of GDP to 0.6 p.p. of GDP in the 2007 scenario.

Second, 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<sup>28</sup> of older workers are currently lower in Austria 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% at this date. 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.

<sup>27</sup> These new projections were not submitted to a peer review in the AWG.

<sup>28</sup> 30% in 2004 and 35.5% in 2006, according to the programme.

### 5.2.3. *Assessment*

The long-term budgetary impact of ageing in Austria is lower than the EU average, with pension expenditure projecting to decrease as a share of GDP over the long-term.

The initial budgetary position contributes to ease the projected long-term budgetary impact of ageing populations. Maintaining high primary surpluses over the medium term, as planned in the programme, would contribute to limiting risks to the sustainability of public finances.

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**

As already signalled in Section 2, 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 rate of social contributions to finance the health sector will be raised by 0.15 percentage points in 2008. Additionally to the planned savings of €300 million in 2007 and 2008 agreed already in the 2005 health care 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.

The update also presents information on two planned comprehensive reforms of the legislation governing the budgetary process in Austria, which have the potential of contributing substantially to the consolidation of public finances. The first one consists in the introduction of the medium-term budgetary framework. The second one concerns the programming of expenditure, moving from input-oriented budgets to ones in which the allocation of budgetary resources is linked to measurable objectives. The first reform was initially planned to come into force on 1 January 2007, but its implementation was delayed for political reasons. The Parliament finally adopted the first reform on 6 December 2007 and it is now expected to come into force on 1 January 2009, in line with what the programme suggested. According to the update, the second reform is expected to be implemented in 2013.

### **Box 5: Reform of the budgetary law**

The first element of the envisaged budgetary legislation reform package is the introduction of a medium term budgetary framework. According to the new rules, the Parliament will be obliged to adopt a four-year plan concerning expenditure limits in the main budgetary categories (such as justice and security, education, research and culture, etc.) and then roll it forward by one year every spring. However, expenditure ceilings will be divided into fixed and flexible ones. The latter will concern areas which rely heavily on cyclical fluctuations such as labour market allocations, pensions, family transfers, etc.

The other part of the package is the idea to change the budgetary law so that it would be driven by outputs and not inputs as is the case currently. According to the proposed amendments, economic stability and sustainability of public finances should be an over-arching goal of budgetary policy. Performance budgeting, transparency, efficiency and accurate presentation of the financial situation by the federal government shall be guiding principles in the budgetary process.

Both the introduction of the medium-term budgetary framework and output-orientated budgeting only concern the federal government and not the sub-national governments.

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

The stability programme is fully consistent with the October 2007 implementation report of the national reform programme. Focussing on the measures with a direct budgetary impact, both the stability programme and the implementation report provide for a shift in spending towards growth-orientated categories, such as R&D, infrastructure and education. Likewise, the implementation report contains information on the reforms of the public administration, health care system, as well as on the introduction of a new medium-term budgetary framework, all of which are key elements of the budgetary consolidation path presented in the stability programme. However, there is a difference in terms of formulation of the goal for the public finance consolidation. The implementation report of the NRP states: “achieving of an almost balanced budget by 2009”, whereas the stability programme aims at achieving a balanced budget in structural terms by 2010.

The update does not contain a qualitative assessment of the overall impact of the National Reform Programme within the medium term fiscal strategy, but it refers to the March 2007 update where such an assessment was carried out. The programme provides information on the direct budgetary costs and savings associated with the main reforms envisaged in the NRP. The budgetary projections in the programme explicitly take into account the public finance implications of the reforms envisaged in the implementation report of the NRP.

### **Box 6: The Commission assessment of the October 2007 implementation report of the national reform programme**

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Austria’s national reform programme<sup>29</sup>.

Austria’s national reform programme identifies the following as key areas: sustainability of public finances, labour market and employment, R&D and innovation, infrastructure, business environment, education and training, as well as environmental and resource management. The 2007 implementation report added "social security system as productive force" as the eight priority. The Commission’s assessment was that Austria has made significant progress in implementing its national reform programme over the 2005-2007 period.

Against the background of strengths and weaknesses identified and the evidence on progress made, the Commission recommended that Austria is recommended to give highest priority to the challenges in increasing the employment rate of older workers and improve education outcomes for vulnerable youth. In addition, Austria should also focus on the areas of: fiscal consolidation (to achieve a balanced budget by 2010); competition in services (in particular in professional services); entrepreneurship education; environmental protection; and gender segregation of the labour market.

The tables below provide an overview of whether the strategy and policy measures in the stability programme are consistent with the broad economic policy guidelines in the area

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<sup>29</sup> Communication from the Commission to the European Council, “Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)”, 11.12.2007, COM(2007)803.

of public finances issued in the context of the Lisbon strategy for growth and jobs. The first table makes the assessment against the integrated guidelines for the period 2005-2008, adopted by the Council in July 2005. The second table makes the assessment against the country-specific recommendations / points to watch and the recommendations for the euro area, adopted by the Council in March 2007. The budgetary strategy in the stability programme is partly consistent with the country-specific recommendations / points to watch and the recommendations for the euro area.

**Table 12: Consistency with the broad economic policy guidelines (integrated guidelines)**

Broad economic policy guidelines (integrated guidelines)	Yes	Steps in right direction	No	Not applicable
<b>1. To secure economic stability</b>				
– 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 <sup>1</sup> .		X		
– Member States should avoid pro-cyclical fiscal policies <sup>2</sup> .				X
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits <sup>3</sup> .				X
– Member States posting current account deficits that risk being unsustainable should work towards (...), where appropriate, contributing to their correction via fiscal policies.				X
<b>2. To safeguard economic and fiscal sustainability</b>				
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		
<b>3. To promote a growth- and employment-orientated and efficient allocation of resources</b>				
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		
<p><u>Notes:</u></p> <p><sup>1</sup>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.</p> <p><sup>2</sup>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”.</p> <p><sup>3</sup>As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.</p> <p><u>Source:</u> Commission services</p>				



**Table 13: Consistency with the broad economic policy guidelines (country-specific recommendations and points to watch)**

Broad economic policy guidelines (country-specific recommendations and points to watch)	Yes	Steps in right direction	No	Not applicable
<b>1. Country-specific recommendations</b>				
– None				X
<b>2. Points to watch</b>				
– achieve the target of a balanced budget in 2008		X		
<b>3. Recommendations for euro area Member States</b>				
– Make use of the favourable cyclical conditions to aim at or pursue ambitious budgetary consolidation towards their medium-term objectives in line with the Stability and Growth Pact, hence striving to achieve an annual structural adjustment of at least 0.5% of GDP as a benchmark		X		
– Improve the quality of public finances by reviewing public expenditure and taxation, with the intention to enhance productivity and innovation, thereby contributing to economic growth and fiscal sustainability		X		
<i>Source:</i> <i>Commission services</i>				

\* \* \*

## Annex 1: Compliance with the code of conduct

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

### (i) Model structure

In terms of its table of contents, the update follows the model structure presented in Annex 1 of the code of conduct.

### (ii) Data requirements

The update adheres broadly to the code of conduct as far as data requirements are concerned. The programme provides all the required and most of the optional data.

The following optional data are missing:

- Table 3 (general government expenditure by function): the column for 2010
- Table 4 detailed categories of stock-flow adjustment (sub-items 5) and “other relevant variables” (items 6 and 7)
- Table 7 some detailed items on long-term sustainability

The table on the external assumptions was provided by the Austrian authorities separately after the submission of the programme.

The tables on the following pages show the data presented in the November 2007 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

### (iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP...	Yes	No	Comments
<i>a. Involvement of parliament</i>			
... mentions status vis-à-vis national parliament.		X	It only mentions that the previous update was discussed by the Parliament in June 2007.
... indicates whether Council opinion on previous programme has been presented to national parliament.		X	Previous update was discussed by Parliament after Commission's recommendation, but before Council's opinion.
<i>b. Economic outlook</i>			
... (for euro area and ERM II Member States) uses “common external assumptions” on main extra-EU variables.	X		
... explains significant divergences with Commission services' forecasts <sup>1</sup> .		X	
... bears out possible upside/downside risks to economic outlook.	X		
... analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.		X	
<i>c. Monetary/exchange rate policy</i>			
... (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable

The SCP...	Yes	No	Comments
<i>d. Budgetary strategy</i>			
... presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
... (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			Not applicable
... (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X		
... backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.	X		Partially
... specifies state of implementation of measures.	X 2007 - 2008	X 2009 - 2010	
<i>e. "Major structural reforms"</i>			
... (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
... includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.			Not applicable
<i>f. Sensitivity analysis</i>			
... includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		no scenario on different interest rates
... (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			Not applicable
<i>g. Broad economic policy guidelines</i>			
... provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.		X	
<i>h. Quality of public finances</i>			
... describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
<i>i. Long-term sustainability</i>			
... outlines strategies to ensure sustainability.	X		
... includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
<i>j. Other information (optional)</i>			
... includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		
<p><u>Notes:</u> SCP = stability/convergence programme; CP = convergence programme  <sup>1</sup>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.</p> <p><u>Source:</u>  Commission services</p>			

**Table 1a. Macroeconomic prospects**

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. Real GDP</b>	B1*g	253.4	3.3	3.4	2.4	2.5	2.5
<b>2. Nominal GDP</b>	B1*g	257.9	5.1	5.8	4.4	4.0	4.0
<b>Components of real GDP</b>							
<b>3. Private consumption expenditure</b>	P.3	140.7	2.1	1.9	2.1	2.3	2.2
<b>4. Government consumption expenditure</b>	P.3	45.5	2.1	2.0	2.3	1.5	1.7
<b>5. Gross fixed capital formation</b>	P.51	51.8	3.8	6.3	3.7	3.6	3.5
<b>6. Changes in inventories and net acquisition of valuables (% of GDP)</b>	P.52 + P.53	0.7	0.3	0.3	0.2	0.2	0.2
<b>7. Exports of goods and services</b>	P.6	140.9	7.5	8.3	6.0	6.0	5.6
<b>8. Imports of goods and services</b>	P.7	125.8	5.6	7.7	6.5	5.7	5.4
<b>Contributions to real GDP growth</b>							
<b>9. Final domestic demand</b>		-	2.0	2.6	2.3	2.0	2.0
<b>10. Changes in inventories and net acquisition of valuables</b>	P.52 + P.53	-	-0.4	-0.3	-0.2	-0.5	-0.4
<b>11. External balance of goods and services</b>	B.11	-	1.3	0.8	0.1	0.5	0.5

**Table 1b. Price developments**

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. GDP deflator</b>		<i>n.a.</i>	1.8	2.4	2.0	1.5	1.5
<b>2. Private consumption deflator</b>		<i>n.a.</i>	2.2	2.3	2.6	2.0	2.2
<b>3. HICP<sup>1</sup></b>		<i>n.a.</i>	1.5	1.9	2.0	2.0	2.0
4. Public consumption deflator		<i>n.a.</i>	2.2	2.3	2.6	2.0	2.2
5. Investment deflator		<i>n.a.</i>	2.4	2.4	2.1	1.6	1.4
<b>6. Export price deflator (goods and services)</b>		<i>n.a.</i>	2.7	1.6	1.1	1.3	1.5
<b>7. Import price deflator (goods and services)</b>		<i>n.a.</i>	3.4	1.2	1.3	2.1	2.0

<sup>1</sup> Optional for stability programmes.

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>1. Employment, persons<sup>1</sup></b>		3556331.7	1.6	1.9	1.1	0.9	0.9
2. Employment, hours worked <sup>2</sup>		6993.4	2.8	2.9	1.9	2.0	2.0
<b>3. Unemployment rate (%)<sup>3</sup></b>		195600.0	4.7	4.3	4.2	4.1	3.9
<b>4. Labour productivity, persons<sup>4</sup></b>		71262.2	1.7	1.5	1.3	1.5	1.5
5. Labour productivity, hours worked <sup>5</sup>		36.2	0.5	0.5	0.5	0.5	0.5
<b>6. Compensation of employees</b>	D.1	125.1	4.3	4.6	4.1	3.7	3.7
<b>7. Compensation per employee</b>		35172.5	2.6	2.7	3.0	2.7	2.7

<sup>1</sup>Occupied population, domestic concept national accounts definition.

<sup>2</sup>National accounts definition.

<sup>3</sup>Harmonised definition, Eurostat; levels.

<sup>4</sup>Real GDP per person employed.

<sup>5</sup>Real GDP per hour worked.

**Table 1d. Sectoral balances**

% of GDP	ESA Code	2006	2007	2008	2009	2010
<b>1. Net lending/borrowing vis-à-vis the rest of the world</b>	B.9	3.2	3.5	3.7	3.7	3.7
<i>of which :</i>						
- Balance on goods and services		n.a.	n.a.	n.a.	n.a.	n.a.
- Balance of primary incomes and transfers		n.a.	n.a.	n.a.	n.a.	n.a.
- Capital account		n.a.	n.a.	n.a.	n.a.	n.a.
2. Net lending/borrowing of the private sector	B.9	4.6	4.2	4.3	3.9	3.4
3. Net lending/borrowing of general government	EDP B.9	-1.4	-0.7	-0.6	-0.2	0.4
<b>4. Statistical discrepancy</b>		0.0	0.0	0.0	0.0	-0.1

**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
<b>Net lending (EDP B.9) by sub-sector</b>							
<b>1. General government</b>	S.13	-3.5	-1.4	-0.7	-0.6	-0.2	0.4
<b>2. Central government</b>	S.1311	-3.7	-1.4	-1.1	-1.0	-0.7	-0.1
<b>3. State government</b>	S.1312	-0.3	-0.1	0.2	0.2	0.2	0.2
<b>4. Local government</b>	S.1313	0.6	0.2	0.2	0.3	0.3	0.3
<b>5. Social security funds</b>	S.1314	0.0	0.0	0.0	0.0	0.0	0.0
<b>General government (S13)</b>							
<b>6. Total revenue</b>	TR	123.3	47.8	47.4	47.5	47.3	47.4
<b>7. Total expenditure</b>	TE <sup>1</sup>	127.2	49.3	48.3	48.1	47.7	47.2
<b>8. Net lending/borrowing</b>	EDP B.9	-3.5	-1.4	-0.7	-0.6	-0.2	0.4
<b>9. Interest expenditure</b>	EDP D.41	7.4	2.9	2.7	2.6	2.5	2.5
<b>10. Primary balance<sup>2</sup></b>		3.8	1.5	2.0	2.1	2.3	2.8
<b>11. One-off and other temporary measures<sup>3</sup></b>		0.0	0.0	-0.2	-0.2	-0.1	0.0
<b>Selected components of revenue</b>							
<b>12. Total taxes (12=12a+12b+12c)</b>		69.9	27.1	26.9	26.9	26.9	26.9
<b>12a. Taxes on production and imports</b>	D.2	36.0	14.0	13.7	13.6	13.6	13.5
<b>12b. Current taxes on income, wealth, etc</b>	D.5	33.8	13.1	13.1	13.2	13.3	13.3
<b>12c. Capital taxes</b>	D.91	0.1	0.1	0.1	0.0	0.0	0.0
<b>13. Social contributions</b>	D.61	41.2	16.0	15.8	15.9	15.8	15.8
<b>14. Property income</b>	D.4	3.6	1.4	1.4	1.3	1.3	1.3
<b>15. Other<sup>4</sup></b>		8.8	3.4	3.4	3.4	3.4	3.5
<b>16=6. Total revenue</b>	TR	123.3	47.8	47.4	47.5	47.3	47.4
<b>p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)<sup>5</sup></b>		108.2	41.9	41.6	41.8	41.7	41.7
<b>Selected components of expenditure</b>							
<b>17. Compensation of employees + intermediate consumption</b>	D.1+P.2	35.5	13.8	13.7	13.7	13.4	13.3
17a. Compensation of employees	D.1	23.9	9.3	9.1	9.1	9.0	8.9
17b. Intermediate consumption	P.2	11.6	4.5	4.6	4.7	4.4	4.3
<b>18. Social payments (18=18a+18b)</b>		60.2	23.4	23.0	23.0	22.9	22.8
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	13.1	5.1	5.0	5.0	5.0	5.0
18b. Social transfers other than in kind	D.62	47.2	18.3	18.0	18.0	17.9	17.9
<b>19=9. Interest expenditure</b>	EDP D.41	7.4	2.9	2.7	2.6	2.5	2.5
<b>20. Subsidies</b>	D.3	7.9	3.1	2.9	2.9	2.9	2.9
<b>21. Gross fixed capital formation</b>	P.51	2.5	1.0	1.1	1.1	1.1	1.0
<b>22. Other<sup>6</sup></b>		13.7	5.3	4.9	4.9	4.9	4.7
<b>23=7. Total expenditure</b>	TE <sup>1</sup>	127.2	49.3	48.3	48.1	47.7	47.2
<b>p.m.: Government consumption (nominal)</b>	P.3	46.5	18.0	17.8	17.9	17.8	17.8

<sup>1</sup>Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

<sup>2</sup>The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

<sup>3</sup>A plus sign means deficit-reducing one-off measures.

<sup>4</sup>P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

<sup>5</sup>Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

<sup>6</sup>D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

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

% of GDP	COFOG Code	2006 <sup>2)</sup>	2010
1. General public services	1	7.0	n.a.
2. Defence	2	0.9	n.a.
3. Public order and safety	3	1.4	n.a.
4. Economic affairs	4	4.8	n.a.
5. Environmental protection	5	0.4	n.a.
6. Housing and community amenities	6	0.6	n.a.
7. Health	7	6.9	n.a.
8. Recreation, culture and religion	8	1.0	n.a.
9. Education	9	5.9	n.a.
10. Social protection	10	20.4	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE <sup>1</sup>	49.3	n.a.

<sup>1</sup>Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

<sup>2)</sup> Austria uses 2006 instead of 2005

**Table 4. General government debt developments**

% of GDP	ESA Code	2006	2007	2008	2009	2010
<b>1. Gross debt<sup>1</sup></b>		61.7	59.9	58.4	57.0	55.4
<b>2. Change in gross debt ratio</b>		-2.7	-2.9	-2.4	-2.5	-2.8
<b>Contributions to changes in gross debt</b>						
<b>3. Primary balance<sup>2</sup></b>		1.5	2.0	2.1	2.3	2.8
<b>4. Interest expenditure<sup>3</sup></b>	EDP D.41	2.9	2.7	2.6	2.5	2.5
<b>5. Stock-flow adjustment</b>		0.0	0.8	0.5	0.6	1.0
<i>of which:</i>						
- Differences between cash and accruals <sup>4</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets <sup>5</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>						
- <i>privatisation proceeds</i>		n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other <sup>6</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
<b>p.m.: Implicit interest rate on debt<sup>7</sup></b>		4.6	4.5	4.5	4.5	4.4
<b>Other relevant variables</b>						
6. Liquid financial assets <sup>8</sup>		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

<sup>1</sup>As defined in Regulation 3605/93 (not an ESA concept).

<sup>2</sup>Cf. item 10 in Table 2.

<sup>3</sup>Cf. item 9 in Table 2.

<sup>4</sup>The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

<sup>5</sup>Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

<sup>6</sup>Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

<sup>7</sup>Proxied by interest expenditure divided by the debt level of the previous year.

<sup>8</sup>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	2006	2007	2008	2009	2010
<b>1. Real GDP growth (%)</b>		3.3	3.4	2.4	2.5	2.5
<b>2. Net lending of general government</b>	EDP B.9	-1.4	-0.7	-0.6	-0.2	0.4
<b>3. Interest expenditure</b>	EDP D.41	2.9	2.7	2.6	2.5	2.5
<b>4. One-off and other temporary measures<sup>1</sup></b>		0.0	-0.2	-0.2	-0.1	0.0
5. Potential GDP growth (%)		2.2	2.4	2.4	2.4	2.2
contributions:						
- labour		0.4	0.5	0.3	0.3	0.1
- capital		0.7	0.8	0.8	0.8	0.8
- total factor productivity		1.1	1.1	1.2	1.2	1.3
6. Output gap		-0.4	0.6	0.6	0.8	1.0
7. Cyclical budgetary component		-0.2	0.3	0.3	0.3	0.4
8. Cyclically-adjusted balance (2 - 7)		-1.2	-1.0	-0.8	-0.5	-0.1
9. Cyclically-adjusted primary balance (8 + 3)		1.6	1.7	1.8	2.0	2.4
10. Structural balance (8 - 4)		-1.2	-0.8	-0.6	-0.5	0.0

<sup>1</sup>A plus sign means deficit-reducing one-off measures.

**Table 6. Divergence from previous update**

	ESA Code	2006	2007	2008	2009	2010
<b>Real GDP growth (%)</b>						
<b>Previous update</b>		3.1	2.7	2.3	2.5	2.6
<b>Current update</b>		3.3	3.4	2.4	2.5	2.5
<b>Difference</b>		0.2	0.7	0.1	0.0	-0.1
<b>General government net lending (% of GDP)</b>	EDP B.9					
<b>Previous update</b>		-1.1	-0.9	-0.7	-0.2	0.4
<b>Current update</b>		-1.4	-0.7	-0.6	-0.2	0.4
<b>Difference</b>		-0.3	0.2	0.1	0.0	0.0
<b>General government gross debt (% of GDP)</b>						
<b>Previous update</b>		62.2	61.2	59.9	58.5	56.8
<b>Current update</b>		61.7	59.9	58.4	57.0	55.4
<b>Difference</b>		-0.5	-1.3	-1.5	-1.5	-1.4



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

% of GDP	2000	2006 <sup>1)</sup>	2010	2020	2030	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	n.a.	25.7	24.7	25.3	27.2	26.2
Pension expenditure	n.a.	13.9	13.4	13.8	15.0	13.1
Social security pension	n.a.	10.3	10.1	10.7	12.2	11.9
Old-age and early pensions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other pensions (disability, survivors)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	n.a.	5.3	5.4	5.9	6.3	6.8
Long-term care ( <i>this was earlier included in the health care</i> )	n.a.	0.6	0.6	0.8	1.0	1.5
Education expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other age-related expenditures	n.a.	5.9	5.3	4.8	4.9	4.8
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Of which</i> : from pensions contributions (or social contributions if appropriate)	n.a.	8.8	9.0	9.0	9.0	8.7
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Of which</i> : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Assumptions</b>						
Labour productivity growth	n.a.	1.8	2.1	1.8	1.7	1.7
Real GDP growth	n.a.	2.2	2.2	1.6	1.0	1.2
Participation rate males (aged 15-64) <sup>2)</sup>	n.a.	76.9	79.2	80.3	80.2	80.8
Participation rates females (aged 15-64) <sup>2)</sup>	n.a.	63.5	67.8	70.6	71.1	71.8
Total participation rates (aged 15-64) <sup>2)</sup>	n.a.	70.2	73.5	75.4	75.7	76.4
Unemployment rate	n.a.	4.7	3.9	3.9	3.9	3.9
Population aged 65+ over total population	n.a.	25.2	26.2	30.9	41.9	52.5

<sup>1)</sup> Austria uses 2006 instead of 2005

**Table 8. Basic assumptions**

	2006	2007	2008	2009	2010
<b>Short-term interest rate<sup>1</sup> (annual average)</b>	3.1	4.3	4.3	4.3	4.3
<b>Long-term interest rate (annual average)</b>	3.8	4.3	4.4	4.5	4.5
<b>USD/€ exchange rate (annual average) (euro area and ERM II countries)</b>	1.26	1.36	1.41	1.41	1.41
<b>Nominal effective exchange rate</b>	0.3	0.9	0.4	0.0	0.0
<b>(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)</b>	n.a.	n.a.	n.a.	n.a.	n.a.
<b>World excluding EU, GDP growth</b>	6.0	5.6	5.3	5.4	5.4
<b>EU GDP growth</b>	3.0	2.9	2.4	2.4	2.4
<b>Growth of relevant foreign markets</b>	10.9	8.2	8.4	8.0	8.0
<b>World import volumes, excluding EU</b>	8.0	7.8	7.1	7.7	7.7
<b>Oil prices (Brent, USD/barrel)</b>	66.2	70.6	78.8	76.0	76.0

<sup>1)</sup>If necessary, purely technical assumptions.

## Annex 2: Key indicators of past economic performance

This annex displays key economic indicators that summarise the past economic performance of Austria. To put the country's performance into perspective, the right-hand side of the table displays the same set of indicators for the euro area.

**Table: Key economic indicators**

	Austria						Euro area					
	Averages			2005	2006	2007	Averages			2005	2006	2007
	'96 - '05	'96 - '00	'01 - '05				'96 - '05	'96 - '00	'01 - '05			
<b>Economic activity</b>												
Real GDP (% change)	2.2	2.9	1.5	2.0	3.3	3.3	2.1	2.7	1.4	1.5	2.8	2.6
<i>Contributions to real GDP growth:</i>												
<i>Domestic demand</i>	1.5	2.3	0.8	1.2	2.0	2.3	2.0	2.7	1.3	1.7	2.6	2.4
<i>Net exports</i>	0.6	0.6	0.7	0.8	1.3	1.0	0.1	0.0	0.1	-0.1	0.2	0.2
Real GDP per capita (PPS; EU27 = 100)	130	132	128	127	127	127	113	114	112	110	110	109
Real GDP per capita (% change)	1.8	2.8	0.9	1.3	2.7	2.8	1.6	2.5	0.8	0.9	2.3	2.2
<b>Prices, costs and labour market</b>												
HICP inflation (%)	1.6	1.2	1.9	2.1	1.7	1.9	1.9	1.5	2.2	2.2	2.2	2.0
Labour productivity (% change)	1.7	2.2	1.1	1.2	1.7	1.6	1.2	1.5	0.8	1.0	1.4	1.1
Real unit labour costs (% change)	-0.9	-1.0	-0.9	-0.4	-1.0	-1.4	-0.5	-0.6	-0.5	-0.8	-0.9	-0.8
Employment (% change)	0.5	0.7	0.3	1.1	1.4	1.4	1.2	1.5	0.9	0.9	1.5	1.6
Unemployment rate (% of labour force)	4.3	4.1	4.4	5.2	4.7	4.3	9.1	9.8	8.5	8.9	8.3	7.3
<b>Competitiveness and external position</b>												
Real effective exchange rate (% change)	-1.6	-3.2	0.0	-0.5	0.0	-0.2	-1.3	-5.5	2.8	-2.6	-0.6	0.6
Export performance (% change) <sup>1</sup>	0.4	-0.4	1.2	0.0	-2.0	0.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.1	-1.4	1.7	3.0	3.3	4.6	0.8	0.9	0.7	0.3	0.0	0.1
<b>Public finances</b>												
General government balance (% of GDP)	-1.6	-2.3	-1.0	-1.6	-1.4	-0.8	-2.3	-2.1	-2.5	-2.5	-1.5	-0.8
General government gross debt (% of GDP)	65.1	65.6	64.7	63.4	61.7	60.0	70.6	72.2	69.0	70.3	68.6	66.6
Structural balance (% of GDP) <sup>2</sup>	n.a.	n.a.	-0.7	-0.9	-1.2	-1.0	n.a.	n.a.	-2.6	-2.1	-1.1	-0.7
<b>Financial indicators</b>												
Short-term real interest rate (%) <sup>3</sup>	2.0	2.8	1.2	0.4	1.3	1.9	1.3	2.5	0.6	0.3	1.2	2.0
Long-term real interest rate (%) <sup>3</sup>	3.6	4.6	2.7	1.6	2.0	2.0	n.a.	n.a.	1.9	1.5	1.9	2.1
<b>Notes:</b>												
<sup>1</sup> Market performance of exports of goods and services on export-weighted imports of goods and services of 35 industrial markets.												
<sup>2</sup> Cyclically-adjusted balance net of one-off and other temporary measures; available since 2003.												
<sup>3</sup> Using GDP deflator.												
<i>Source:</i>												
<i>Commission services</i>												