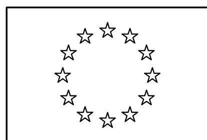

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 24.6.2009
SEC(2009) 869 final

Recommendation for a

COUNCIL OPINION

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

On the updated stability programme of Austria, 2008-2013

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact acknowledged its usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. In particular, it introduced greater flexibility in the application of the rules governing the excessive deficit procedure, notably with regard to the definition of "exceptional circumstances" and the setting of deadlines for the correction of an excessive deficit.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme and annual updates thereof. Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of Austria, submitted on 21 April 2009, and has adopted a recommendation for a Council opinion on it[2].

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

(1) the Commission Communication of 26 November 2008 (“A European Economic Recovery Plan”); and

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

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[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

[2] The Stability and Growth Pact requires the Commission to prepare a report under Article 104(3) of the Treaty when an actual or planned deficit exceeds the 3% of GDP reference value. In view of the great uncertainty surrounding the current economic juncture, the Commission considers it appropriate that reports based on planned deficits for 2009 in excess of the reference value take account of further information.

2.1. The Commission Communication of 26 November 2008 ("A European Economic Recovery Plan")

In view of the unprecedented scale of the global financial and economic crisis, the European Commission has called for a European Economic Recovery Plan (EERP)[3]. The plan proposes a co-ordinated counter-cyclical macroeconomic response to the crisis in the form of an ambitious set of actions to support the economy consisting of (i) an immediate budgetary impulse amounting to €200 billion (1.5% of EU GDP), made up of a budgetary expansion by Member States of € 170 billion (around 1.2% of EU GDP) and EU funding in support of immediate actions of the order of € 30 billion (around 0.3 % of EU GDP); and (ii) a number of priority actions grounded in the Lisbon Strategy and designed to adapt our economies to long-term challenges, continuing to implement structural reforms aimed at raising potential growth. The plan calls for the fiscal stimulus to be differentiated across Member States in accordance with their positions in terms of sustainability of government finances and competitive positions. In particular, for Member States outside the euro area with significant external and internal imbalances, budgetary policy should essentially aim at correcting such imbalances. The plan was agreed by the European Council on 11 December 2008. In this context, Member States were asked to submit an addendum to their updated stability or convergence programme, so as to reflect the measures taken in the context of the Recovery Plan. While it is still relatively early to assess the impact of these measures, the opinions of stability and convergence programmes include a preliminary evaluation of how measures (budgetary measures as well as structural measures) contribute to the recovery process in the short term.

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

In its opinion of 4 March 2008, the Council summarised its assessment of the previous update of the stability programme, covering the period 2007-2010, as follows. The Council considered that "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 Council invited Austria to "take advantage of the slightly lower-than-targeted deficit outcome in 2007 to strengthen the adjustment effort in 2008 as well as to underpin the adjustment planned for the two final years of the programme with specific and sufficient measures, including financing of the envisaged tax reform" and stated that "in this way, the MTO should be achieved earlier than foreseen in the programme, in particular by more rigorously implementing expenditure restraint and by using any unexpected tax revenues for budgetary consolidation".

[3] Communication from the Commission to the European Council - COM(2008) 800, 26.11.2008.

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On the updated stability programme of Austria, 2008-2013

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [7 July 2009] the Council examined the updated stability programme of Austria, which covers the period 2008 to 2013.

(2) The direct impact of the global financial crisis on the Austrian economy has been relatively contained, although the financial sector suffered from a massive slump in profits especially from banks' foreign activities in Central and Eastern Europe in 2008. As a small and strongly export-oriented economy, Austria is affected by the global recession mainly via the contraction in international trade resulting in a setback in foreign demand in 2009. The manufacturing sector is expected to suffer most, as goods exports are expected to fall sharply, dragging down also private fixed investment. The Commission services' spring 2009 forecast projects real GDP to shrink by 4% in 2009, followed by stagnation in 2010. The rise in unemployment has so far been kept in check by the reduction in overtime and recourse to short-time work, but in the wake of the economy sliding into a recession, the jobless rate is set to increase sharply from 3.8% in 2008 to 7% in 2010. As a consequence, sizeable government revenue losses and additional expenditure due to automatic stabilisers (estimated at 2¼% of GDP in 2009) and discretionary measures (estimated at 1¼% of

[4] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

GDP in 2009) to sustain business activity and household income and stabilise financial markets will weigh significantly on Austria's public finances.

(3) The macroeconomic scenario underlying the April 2009 stability programme envisages that real GDP growth will fall from 1.8% in 2008 to -2.2% in 2009 before recovering to an average rate of 1.6% until the end of the programme period in 2013. Assessed against currently available information[5], this scenario appears to be based on markedly favourable growth assumptions. Most notably, the programme assumptions for exports and gross fixed capital formation in 2009 are considered to be decidedly optimistic. From 2010, a swift recovery is projected to bring real GDP growth back to potential already in 2011. The programme's projections for inflation of 0.6% in 2009 and 1.1% in 2010 appear realistic.

(4) In 2008, the general government deficit of 0.4% of GDP was slightly below the target of 0.6% set in the previous update of the stability programme. A higher-than-anticipated revenue outturn was mainly owed to a carry-over effect from 2007. These extra revenues more than offset the cost of new policy measures taken to curb the loss in household purchasing power due to higher inflation, such as reduced social contribution rates for low-income earners and increased social payments, including measures such as higher outlays for pension benefits and energy cost allowances. As a consequence, the expenditure-to-GDP ratio was about ½ percentage point above expectations. Overall, the budget balance for 2008 was only moderately affected by the dramatic changes in the economic environment - both the revenue shortfalls and the government's stabilisation measures will essentially take effect from 2009 onwards.

(5) The updated stability programme targets a general government deficit of 3.5% of GDP for 2009, which compares with a projected deficit of 4.2% of GDP in the Commission services' spring 2009 forecast. The government has taken sizeable discretionary fiscal counter-action to the tune of 1¼% of GDP[6]. Some of these measures were already taken in 2008 to protect households' purchasing power in the face of rising inflation, but will largely remain effective in 2009 (0.4% of GDP). In addition to discretionary measures, automatic stabilisers will operate, yielding an expansionary impact of 1¾% of GDP[7]. Furthermore, the front-loading of off-budget construction projects by state-owned enterprises may account for another ¼% of GDP. Judging by the decline of the structural balance, the fiscal stance is expansionary.

(6) Austria's medium-term objective (MTO) is to achieve a balanced budget, which is part of a more comprehensive three-pillar budgetary strategy including also public investment schemes and structural reform in public administration. The programme update foresees the general government deficit to widen further to 4.7% of GDP in 2010 and remain at that level until 2012. In 2013, the deficit is to narrow slightly to 3.9% of GDP. Hence, the MTO will not be achieved within the programme period.

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5 The assessment notably takes into account the Commission services' January 2009 forecast, but also other information that has become available since then.

6 In addition, support is offered to credit-constrained enterprises, provided mainly as guarantees that have a budgetary effect only if called.

7 Recalculated by Commission services on the basis of information provided in the stability programme. The difference to the Commission services' estimates based on the Spring 2009 forecast is due to the different macroeconomic scenario (see paragraphs 2 and 3).

Driven by the fiscal stimulus measures in response to the crisis, the expenditure-to-GDP ratio will increase by 2.6 percentage points between 2008 and 2010. At the same time, the revenue-to-GDP ratio is expected to fall by 1.8 percentage points as a result of discretionary tax cuts and the cyclical erosion of tax bases. The structural deficit (i.e. the cyclically-adjusted balance net of one-off and other temporary measures, recalculated by Commission services on the basis of the information provided in the programme using the commonly agreed methodology) is projected to widen to 3% of GDP in 2009 and further to around 4% from 2010 to 2012. A substantial part of the measures included in the recovery programme will be permanent, thus the reversibility of policies adopted in response to the crisis is not ensured. Starting from 62.5% of GDP in 2008, the government gross debt ratio is projected to increase by 16 percentage points until 2013. Further to the rise in the government deficit and the decline in GDP growth, a significant stock-flow adjustment largely reflecting financial sector stabilisation measures contributes to the rise in the debt ratio.

(7) The budgetary outcomes are subject to significant downside risks. First, the markedly favourable growth assumptions of the underlying macroeconomic scenario are surrounded by considerable uncertainty with respect to the duration, extent and macroeconomic impact of the financial crisis. Revenue projections therefore appear optimistic and the programme provides only limited information on consolidation efforts envisaged from 2010 onwards. Moreover, there is a risk stemming from the financial market stabilisation package offered to banks in distress, and public guarantees, which if called, may substantially increase the deficit. In view of sizeable guarantees given to the business and financial sector and potential further capital injections, there are negative risks to the budgetary targets compounded by uncertainty about the stock-flow adjustment, also the debt ratio may rise more steeply than projected in the programme.

(8) The long-term budgetary impact of ageing in Austria is lower than the EU average, with pension expenditure projected to increase only slightly as a share of GDP over the long-term. The budgetary position in 2008, as estimated in the programme, is weaker than the starting position of the previous programme, compounding the budgetary impact of population ageing on the sustainability gap. If the 2009 budgetary position as projected by the Commission services Spring 2009 forecast were taken as the starting point, the sustainability gap would widen substantially. Moreover, the current level of gross debt is above the Treaty reference value. The long-term sustainability of public finances would be further undermined if the above-mentioned risks from financial sector stabilisation schemes materialise, to the extent that costs of the government support are not recouped in the future. Achieving high primary surpluses over the medium term, e.g. by raising the effective retirement age, would contribute to reducing risks to the sustainability of public finances, which are currently at a medium level.

(9) Despite the overall sound quality of public finances and fiscal rules, there is still room for improvement of Austria's institutional budgetary framework. Austria's federal fiscal relations – governed by the Fiscal Equalisation Law 2008-2013 and the Domestic Stability Pact 2008 – are rather complex and lack transparency due to overlapping responsibilities, co-administration and co-financing at all three levels of government. The resulting scope for efficiency gains in several areas of public spending should be used, in particular in health care and education. In this context, the 2009 programme update cites the formation of working groups on further reforms of

the fiscal equalisation act as well as health and elderly care system. However, tangible proposals are not expected before 2011. At the federal level, Austria embarked on a far-reaching reform of budgetary legislation as a new multi-annual expenditure framework with fixed ceilings set for four consecutive years entered into force as of 1 January 2009 (Federal Budgetary Framework Act – *Bundesfinanzrahmengesetz*). It is expected to help prevent pro-cyclical spending and enhance the effectiveness of the automatic stabilisers. Starting as of 2013, the introduction of output-based budgeting ("performance budgeting") and the modernisation of the accounting system of public finances are foreseen.

(10) To stabilize financial markets**,** the Austrian authorities have adopted several measures, including guarantees of bank deposits held by individual persons (unlimited until end of 2009, thereafter up to €100000; for deposits held by small and medium sized enterprises the upper ceiling is €50,000). Further incentives have been provided for private household saving through savings and loan associations (*Bausparförderung*), aimed at safeguarding mortgage loan home financing. For interbank loans and bond issues by the newly funded Austrian Clearing Bank (*OeCAG*) and for commercial paper issues by commercial banks, the Austrian government provided guarantees up to €75 billion (27% of GDP). Finally, the government has allocated up to €15 billion (5½% of GDP) for capital injections to financial institutions, of which €6.4 billon have been claimed by the mid-May, but only €4.7 billion were demanded so far.

(11) In view of a fiscal position almost close-to-balance in 2008 and the absence of external imbalances, the fiscal stimulus for 2009 and 2010 adopted by the Austrian government is deemed an adequate response to the economic downturn. In line with the European Economic Recovery Programme agreed in December by the European Council, Austria's recovery packages were introduced timely, since a large part of the measures took effect in the first quarter of 2009. The labour market measures adopted are intended to rein in lay-offs and improve vocational training. Support to credit-constrained enterprises comes mainly in off-budget form as guarantees and subsidised loans. Most of the stimulus is provided via private income support, with revenue concessions (1 to 1½% of GDP) dominating additional expenditure (around ½% of GDP). As the major part of the recovery measures will be permanent (85%), the reversibility of the fiscal stimulus is a concern. Although the reduction in direct taxes and social contributions (especially for low income groups) comply with the government's long-term objective of reducing the high tax burden on labour and providing stronger incentives to work, the gap in public finances remains to be addressed, as the updated stability programme does not foresee any significant consolidation before 2013. Some of the stimulus measures are related to the medium-term reform agenda and the country-specific recommendations proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs and endorsed by the Spring European Council on 19 March. They aim at strengthening the growth potential (infrastructure and R&D investment) and address long-term challenges such as climate change with a focus on energy efficiency and reduced CO_2 emissions.

(12) Following fiscal expansion in 2009 and 2010, the fiscal stance is considered to be broadly neutral in the outer years, as the structural balance is planned to change only marginally in 2011/12 and to improve by ½% of GDP in 2013. The deficit is expected to exceed the 3% of GDP reference value by a sizeable margin between 2009 and 2013, with consolidation to be resumed only at the end of the programme period. The

programme announces that "the Austrian government will take all measures needed to achieve a correction until 2012" in order to avoid lasting excess of the 3% of GDP reference value. However, there is no clearly defined action to ensure deficit reduction before 2013. Similarly, the debt ratio is projected to exceed the Treaty reference value throughout the programme period, with the rising trend reflecting the expansionary stance in 2009 and 2010 and the budgetary effects of the stabilisation measures undertaken.

(13) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides nearly all of the compulsory data and has some gaps the optional data[8].

The overall conclusion is that fiscal policy in Austria will be expansionary in 2009 and 2010; the narrowing of the general government deficit to ½% of GDP by 2008, driven by strong economic growth in the last years and the absence of external imbalances, gave the Austrian government room for manoeuvre to introduce a sizeable fiscal stimulus in response to the crisis. The response was timely and commensurate to the distress in the financial sector as well as to the scale and pace of the economic downturn. Nevertheless, the measures taken are only partly in line with the general principles of the European Economic Recovery Plan (EERP) since the major part of them is of a permanent nature. Hence a credible and sound strategy is needed for budgetary consolidation to resume as soon as the crisis abates. Yet, the stability programme foresees no reduction in government net borrowing before 2013 (at constant policies), although GDP growth is projected to pick up as from 2010. Moreover, given the markedly benign assumptions for GDP in 2009 and beyond, the authorities' budgetary projections are subject to substantial downside risks. The direct budgetary implications of the support programmes for enterprises and commercial banks are currently estimated to be limited, as large parts of them are off-budget in the form of guarantees. However, if the number of non-performing domestic and foreign loans increases, public finances would deteriorate further, as additional capital injections by the government would then become necessary.

In view of the above assessment Austria is invited to:

(i) implement the stimulus measures in line with the EERP as planned, but reverse the expansionary fiscal stance once the economic crisis subsides so as to return to a consolidation path compatible with the long-term sustainability of public finances;

(ii) substantiate the government's intention mentioned in the programme to implement measures deemed necessary to achieve a general government deficit below the 3% of GDP reference value by 2012 at the latest;

(iii) further improve the budgetary framework to strengthen fiscal discipline at all levels of government through enhanced transparency and accountability notably by aligning legislative, administrative and financing responsibilities between the different levels of government.

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[8] In particular, the programme does not provide the levels of the external assumptions for 2007. Of the optional data, detailed categories of net lending vis-à-vis rest of the world, detailed categories of stock-flow adjustment and some detailed items on long-term sustainability are missing.

Comparison of key macro-economic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Apr 2009**	**3.1**	**1.8**	**-2.2**	**0.5**	**1.5**	**2.0**	**2.3**
	COM Spring 2009	3.1	1.8	-4.0	-0.1	n.a.	n.a.	n.a.
	SP Nov 2007	*3.4*	*2.4*	*2.5*	*2.5*	*n.a.*	*n.a.*	*n.a.*
HICP inflation (%)	**SP Apr 2009**	**2.2**	**3.2**	**0.6**	**1.1**	**1.3**	**1.5**	**1.9**
	COM Spring 2009	2.2	3.2	0.5	1.1	n.a.	n.a.	n.a.
	SP Nov 2007	*1.9*	*2.0*	*2.0*	*2.0*	*n.a.*	*n.a.*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Apr 2009**	**2.5**	**2.6**	**-0.9**	**-1.7**	**-1.6**	**-1.2**	**-0.5**
	COM Spring 2009[2]	2.7	2.9	-2.2	-3.3	n.a.	n.a.	n.a.
	SP Nov 2007	*0.4*	*0.4*	*0.5*	*0.5*	*n.a.*	*n.a.*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Apr 2009**	**3.2**	**2.9**	**1.6**	**0.6**	**1.0**	**1.3**	**1.4**
	COM Spring 2009	3.3	3.3	2.7	2.4	n.a.	n.a.	n.a.
	SP Nov 2007	*3.5*	*3.7*	*3.7*	*3.7*	*n.a.*	*n.a.*	*n.a.*
General government revenue (% of GDP)	**SP Apr 2009**	**48.0**	**48.2**	**47.5**	**46.5**	**46.4**	**46.1**	**46.1**
	COM Spring 2009	48.0	48.2	47.4	46.7	n.a.	n.a.	n.a.
	SP Nov 2007	*47.4*	*47.5*	*47.3*	*47.4*	*n.a.*	*n.a.*	*n.a.*
General government expenditure (% of GDP)	**SP Apr 2009**	**48.7**	**48.7**	**51.1**	**51.3**	**51.1**	**50.9**	**50.1**
	COM Spring 2009	48.5	48.6	51.6	52.1	n.a.	n.a.	n.a.
	SP Nov 2007	*48.3*	*48.1*	*47.7*	*47.2*	*n.a.*	*n.a.*	*n.a.*
General government balance (% of GDP)	**SP Apr 2009**	**-0.5**	**-0.4**	**-3.5**	**-4.7**	**-4.7**	**-4.7**	**-3.9**
	COM Spring 2009	-0.5	-0.4	-4.2	-5.3	n.a.	n.a.	n.a.
	SP Nov 2007	*-0.7*	*-0.6*	*-0.2*	*0.4*	*n.a.*	*n.a.*	*n.a.*
Primary balance (% of GDP)	**SP Apr 2009**	**2.3**	**2.2**	**-0.6**	**-1.7**	**-1.4**	**-1.3**	**-0.4**
	COM Spring 2009	2.2	2.1	-1.1	-2.1	n.a.	n.a.	n.a.
	SP Nov 2007	*2.0*	*2.1*	*2.3*	*2.8*	*n.a.*	*n.a.*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Apr 2009**	**-1.7**	**-1.6**	**-3.1**	**-3.9**	**-4.0**	**-4.1**	**-3.7**
	COM Spring 2009	-1.8	-1.8	-3.2	-3.8	n.a.	n.a.	n.a.
	SP Nov 2007	*-0.9*	*-0.8*	*-0.4*	*0.1*	*n.a.*	*n.a.*	*n.a.*
Structural balance[3] (% of GDP)	**SP Apr 2009**	**-1.7**	**-1.6**	**-3.1**	**-3.9**	**-4.0**	**-4.1**	**-3.7**
	COM Spring 2009	-1.8	-1.8	-3.2	-3.8	n.a.	n.a.	n.a.
	SP Nov 2007	*-0.7*	*-0.6*	*-0.4*	*0.1*	*n.a.*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**SP Apr 2009**	**59.4**	**62.5**	**68.5**	**73.0**	**75.7**	**77.7**	**78.5**
	COM Spring 2009	59.4	62.5	70.4	75.2	n.a.	n.a.	n.a.
	SP Nov 2007	*59.9*	*58.4*	*57.0*	*55.4*	*n.a.*	*n.a.*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 1.8%, 1.7%, 1.3% and 1.3% respectively in the period 2007-2010.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. There are no one-off and other temporary measures in the most recent programme and Commission services' spring 2009 forecast

Source:

Stability programme (SP); Commission services' spring 2009 forecasts (COM); Commission services' calculations.