Recommendation of the Government Debt Committee on Budget Policy and Financing 2013

Resolved in the meeting of the working committee on December 5, 2012, and approved in the meeting of the Government Debt Committee on December 13, 2012

Framework Conditions

Momentum in the global economy is expected to be weak in the year 2013. The most recent international forecasts for the **euro area** are based on the assumption that the recession will continue in the first half of 2013, after real economic output fell by 0.4% (source: OECD) on a yearly basis in 2012. It is mainly the bleak domestic demand in the euro area that is dampening economic development. Economic recovery is expected for the second half of 2013. On the whole, stabilization of the European economy is based on strong confidence in the EU on the part of economic players, which would have to be achieved by credible and substantial progress in the area of European integration (e.g. agreement on the future banking union) as well as by continuing adjustments of macro-economic imbalances in euro-area countries. Downward risks persist, in particular, due to a financial and debt crisis that is once again worsening.

For **Austria,** economic development is expected to be more favorable than that of the euro area as a whole: At present, full-year GDP growth in 2013 is forecast to be from 0.5% to 1.0%, which is similar to the year 2012. In the first half of 2013 the phase of weak economic growth on an annual comparison is likely to continue. Important stimuli are likely to come from exports, in particular from the German market, which slowly but steadily will recover over the course of the year. The weak order intake and industrial capacity utilisation will curb investment demand – in spite of the low interest-rate level in Austria. In addition, public and private consumption will probably only stimulate domestic demand to a limited degree.

On the **Austrian labor market** a slowing of vigorous employment growth and an increase in unemployment in the year 2103 has become apparent: The average number of (actively) employed persons will increase by approximately 20,000 on the previous year (2012 by approximately 47,000). In the same period the average number of those unemployed will rise by about 20,000 (2012 by approximately 14,000). The number of unemployed persons will be significantly higher than before the crisis as a result of a higher labor supply and weak economic activity. According to the European Commission, the unemployment rate of Austria will rise from 4.5% (2012) to 4.7% (2013), but will remain the lowest in the EU.

According to the (recent) Austrian Stability Program of April 2012 a rate of 2.1% of GDP was targeted for the **deficit of the general government of Austria** in the year 2013 (2012: 3.0 %) and that rate should gradually be reduced to zero by the year 2016. Additional measures in the framework of the Austrian bank rescue package and the weak economic situation could, however, cause the set budget objective to be slightly exceeded in 2013. The **current estimate of the Federal Ministry of Finance** is based on a general-government budget deficit of 2.3% of GDP for 2013 (2012: 3.1% of GDP). The **planned consolidation path** to be completed by 2016, which was introduced in 2010 in Loipersdorf and was continued by means of the Stability Package from spring 2012, contains a package of **fiscal and expenditure measures** (e.g. financial stability contribution of banks, increase in the fuel tax, taxation on income from the sale of securities, taxation on earnings from the sale of real estate, financial transaction tax, solidarity contribution for high incomes, restrictions applied to the right to deduct VAT, a reduction of the thirteenth-month family grant, low salary and pension settlements, structural reforms to increase the effective age of retirement, restrictive personnel policy, as well as **"offensive measures"** to promote growth and employment, such as, for example, in the area of universities and universities of applied sciences (Fachhochschulen) as well as long-term care.

Under the assumption that the consolidation path is adhered to, **the excessive deficit procedure for Austria** will be discontinued in the course of the year 2013: In addition to falling below the reference value for the general-government deficit in the amount of 3% of GDP from the year 2013 onwards in a sustainable manner, the **decrease in the structural deficit** (in % of GDP) is likely to correspond with the Council recommendations of an average of 0.75 p.a. in the years between 2011 and 2013, if the revisions of potential growth are taken into consideration. The recent calculations of the European Commission for the years 2011 to 2013 show a lower potential output level than was expected at the point of time of the ED recommendations (December 2009). For 2012 to 2014 potential growth rates were determined to be only 1.2% p.a. (EC forecast from autumn 2012) while in autumn 2009 assumptions were based on growth rates in the range of 1.6% p.a.

At the end of the year 2013 (Federal Ministry of Finance-Budget Report of October 2012), a **public debt rate** of 75.4% of GDP (2012: 74.7% of GDP) is expected. Starting from this peak level there should be a gradual decrease in accordance with the debt rules of the European Stability and Growth Pact.

Recommendations of the Government Debt Committee

On the backdrop of the persistent financial and economic crisis, the high public-debt level, the EU legal measures on budget discipline and under the present economic framework conditions expected **for the year 2013, the Government Debt Committee recommends the following:**

- To strictly **continue** the **moderate consolidation course** that has been pursued since 2011 in spite of weak economic periods and the upcoming elections. There must not be any doubts about a reduction of the general-government budget deficit on a sustainable basis to below 3% of GDP from 2013 onward, a national budget that is balanced to the extent possible by the year 2016 and the following years, and also a trend reversal in the development of the debt ratio.

- To allow **cyclical** changes in revenues and expenditures in the budget (automatic stabilizers) to **take full effect**. If employment-policy measures are taken, these should be as efficient as possible and counterfinanced.

- Not to pass **any politically motivated increases in expenditures or revenue reductions** (“election gifts”), which will additionally intensify the savings requirement in the following legislature period.

- To plan **counterfinancing** for **revenue reducing measures** in the coming years. **Tax reforms** should mainly result in structural changes and aim at relieving the **factor labor in Austria** and **eliminating special provisions** (exceptions). Budget consolidation needs to take precedence over any tax reductions.

- To **continue to push forward** with **fundamental policy decisions** concerning **competence** and **structural reforms** applying to **all levels of government** including the area of administrative efficiency, education, civil-servant pension law, grants, local public transport as well as fiscal competence of the provinces and municipalities and to strictly implement the health-care system reform that was passed in 2012. If structural measures are not taken, pressure to consolidate is passed on to those areas that contribute to sustainable growth. Numerous recommendations for such reforms are available (RH, WIFO, IHS, StA, KDZ (Court of Audit, Austrian Institute of Economic Research, Institute for Advanced Studies, Government Debt Committee, KDZ-Centre for Public Administration Research)).

- To intensify the **changes** implemented by the new **Federal Budget Law 2013** (Bundeshaushaltsrecht) toward a focus on results and effectiveness (which results are to be reached by means of the tax money), self-responsibility and transparency on the federal level. The Government Debt Committee welcomes the new fiscal architecture including the implementation of gender budgeting and pleads for intensified **decentralized personnel management** and

adjusted organizational structure of the federal government to avoid overlapping of competences and diverging outcome objectives. Additionally it seems advisable to report released reserves (to the extent known) in the notes to the budget. Additionally, each **overview of the impact assessments** of **legal norms** should be attached as supplement to the reports made by the outcome-monitoring authority of the Federal Chancellery to the National Assembly. The most recent budget law of the federal government also gained international recognition.

- **On the basis of the new Federal Budget Law 2013,** to implement **compatible budget regulations on the subnational level** and to abolish existing **regional deviations**. In order to have an effective overall control system of financial policy and to implement significant plans in Austria, meaningful and comparable information on the budget situation, medium-term budget development, net assets and on contingent liabilities of the provincial and local levels of government are required. To this effect, there is an urgent need for a comprehensive reform of the Austrian **Budgeting and Accounts Regulation.**

- To work out **much simpler and workable implementation requirements** on the **provincial and municipal levels** for **compliance with the "debt brake"** in the form of the **Austrian Stability Pact 2012**, which retroactively became effective on January 1, 2012, in accordance with the implementation guidelines of the EU (resolution of the ECOFIN Council of January 24, 2012, "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes") and **to intensify** the **coordination work** (especially on an ex ante basis) of the **Federal and Provincial Coordination Committees** planned in the Austrian Stability Pact. A draft has been made of the guidelines on the federal level to implement the debt brake and the Austrian Stability Pact.

- To significantly intensify the work carried out by the group **"Fundamental Reform of Revenue Sharing"** as well as the **political discussion process** in this connection and at the latest by 2016 to develop and implement a **new task-oriented revenue-sharing system with more direct responsibility and fiscal autonomy**. Other institutions, such as the OECD and IMF have repeatedly pointed out the need for a fundamental reform of the financial links of the various levels of government. Comprehensive studies on Austrian revenue sharing that suggest options for change have been available for a long time. From the point of view of the Government Debt Committee, establishing **fiscal equivalence** (matching of the beneficiaries and the bearers of cost) and also **connectivity** (combining responsibilities for tasks, expenditures, and revenues) are, above all, of significance. In addition to these efficiency criteria, fiscal equalization would, however, have to take into account the capabilities of regional authorities and include elements of an equalization of resources for structurally weak regions, as well as an equalization of burdens, e.g. for central tasks.

- To develop **strict, unified, clear standards** for **investment and financing transactions (including transparency),** which from now on are to be only low-risk transactions, for all provincial and municipal governments and to make provincial and municipal level guidelines more binding. Such guidelines could be used as decision-making criteria for authorizations by the provincial parliament (Landtag) or for municipal supervisory bodies to assess and approve financial transactions of municipalities.

- To take advantage of the at present extremely low interest-rates for **long-term funding with fixed interest rates** on all levels of government.

- On the **European level**, to make a contribution to ensuring that the adjustment of public budgets, the creation of suitable framework conditions for more growth and employment, and also the strict implementation measures to stabilize financial markets and banks, which guarantee fair competition, will **effectively complement each other**. The **required measures** to resolve the public debt crisis are **to be taken**, as all countries in the euro area – including Austria – benefit greatly from the common economic and currency area.

Excursus: Fiscal Framework of the European Union and its legal Implementation in Austria

To the extent that exceptional rules (e.g. extraordinary events such as natural catastrophes, serious recessions) are not to be applied, the following EU requirements are valid for Austria:

- As long as the **structural budget deficit of the general government** (cyclically-adjusted budget balance not including one-off and other temporary measures) has not reached the national medium-term budgetary objective (MTO), **the structural deficit rate** must be reduced **by about 0.5% of GDP on an annual basis**. In periods of favorable economic growth and if the debt ratio is more than 60% of GDP, this adjustment must be accelerated.
- According to the Council recommendations (December 2009), in view of the **procedure due to the "excessive deficit"** (ED Procedure), Austria has the obligation
  - to reduce the deficit rate to **below 3% of GDP by 2013,**
  - to **reduce** the average, **annual deficit (structurally) by 0.75% of GDP** in the years 2011 to 2013 and
  - to achieve a reduction in the debt ratio.
- After the ED Procedure has been ended, the annual (real) **expenditure growth of the state** must not **exceed the medium-term growth rate of potential output** unless there is discretionary compensation by means of revenues. As long as the medium-term budgetary objective (MTO) has not been reached, the growth rate is to be curbed more vigorously. In Austria this reduction is about one percentage point.
- In **reducing government debt ratios** it must be ensured that the **gap to the reference value of 60% of GDP** in the past three years (years t-1 to t-3) or on the basis of the forecast of the European Commission (no-policy-change assumptions; years t-1, t, and t+1) is **reduced** by an average of **5% per year**. For member states that are subject to an ED Procedure, there is a **three-year transition period**. Compliance to the debt rules should be ensured at the end of the transitional period.
- **Minimum standards for fiscal architecture** in EU member states (including national fiscal rules, budgetary framework with a planning horizon of at least three years, federal control and coordination mechanisms, more transparency (also in units with close ties to the government)), which are to be applied on a federal level by the **end of 2013**.
- **Translating EU requirements into national law** on the basis of the **"Fiscal Compact"** (Treaty on Stability, Coordination and Governance in the EMU). It is included in this treaty that the EU requirement of a structurally balanced budget (minimum of –0.5% of GDP) is to be implemented by the member states on a national level in a manner that is legally binding and permanent. In addition, member states must set up an **automatic correction mechanism**.

Fiscal EU requirements were translated into Austrian national law by means of the **Austrian Stability Pact 2012**, which became effective retroactively at the beginning of 2012. As a **medium-term budgetary objective** (MTO), the Austria Stability Pact 2012 provides for a maximum **general-government structural budget deficit of 0.45% of GDP starting with the year 2017** (federal government and social insurance institutions: 0.35% of GDP; provinces and municipalities: 0.1% of GDP), allowing automatic stabilizers to take effect, exceptions in extraordinary circumstances, and reestablishing a budget buffer ("control account") that allows the additional, non-discretionary deficit to be exceeded by as much as 1.6% of GDP. Up to the present the debt brake has not been incorporated in the Austrian constitution.