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

Resolved in the meeting of the working committee on June 26, 2013, and approved in the meeting of the Government Debt Committee on July 3, 2013

Framework Conditions

Taken as a whole, in 2013 the global economy will remain weak (2013: +3.3%, 2012: +3.2%; IMF forecast), even though a slight upturn of the global economy is forecast for the second half of the year. In the **euro area** economic output in 2013 will once again contract in comparison with the previous year (according to the European Commission 2013: -0.4%, 2012: -0.6%). However, as a result of increasing foreign demand, the European Commission foresees moderate economic growth even in the euro area. Economic development in Europe is still characterized by wide disparities among the countries of the euro area. On the whole it is not likely that there will be any growth momentum from domestic demand – in light of weak sales, restrained economic expectations, limited credit supply in several European countries and consolidation efforts of public budgets. In addition, the high unemployment rate and economic uncertainty are weakening private consumption in the euro area. There are downward risks caused by the fact that the financial and debt crisis is once again intensifying.

For **Austria** in 2013 a more favorable economic development in comparison with the euro area is expected; however, real GDP – at about 0.5% on the previous year – will expand only very moderately (2012: +0.8%). The decisive factor is the more subdued export activity as a result of the loss of demand in important importing countries, accompanied by a stagnation of the domestic level of investment. For the second half of the year domestic research institutes are predicting a slight recovery of Austria's economy. That is due to the gradually improving external environment, which is expected to result in an impetus for domestic export and investment activity. In light of the weak development of disposable household income in real terms (weak trend of real income, cold progression, low income from assets) expenditures for private consumption are likely to all but stagnate.

The **Austrian labor market** is characterized by the persistently weak economic phase that has significantly curbed last year's buoyant employment growth and further increased unemployment: The average number of actively employed persons will rise by about 20,000 persons on the previous year (2012: +47,000 persons). In the same time period the average number of unemployed will increase in the range of 20,000 persons (2012: 14,000 persons). In addition to the weak economy, the expansion of the supply of workers since 2011 as a result of the opening of the domestic labor market to southeast European countries has taken effect. According to the European Commission the unemployment rate will rise from 4.3% (2012) to 4.7% (2013), but will probably remain the lowest in the EU.

A slight reduction in the **general government deficit of Austria** of 0.2 percentage points to 2.3% of GDP was planned in the present Austrian Stability Program of April 2013 (2012: 2,5%). Thus the consolidation path, which was introduced in October 2010 in Loipersdorf and supplemented by two stability packages in spring 2012, is being continued. By 2016 a balanced budget of the general government is scheduled to be achieved. The **consolidation path** is composed of a combination of **fiscal measures** and **measures from the expenditure side** and is accompanied by **"offensive measures"** to promote growth and employment. According to the most recent stability program, the **public debt rate** will reach 73.6% of GDP by the end of 2013 (2012: 73.4% of GDP). On the basis of this peak level, according to the most recent stability program, a gradual reduction is to take place in line with the debt rule of the European Stability and Growth Pact.

In May 2013 the **European Commission** determined that, considering the difficult economic conditions, Austria managed to **assert itself well** and that **progress towards complying with** the multidimensional **fiscal rules** is likely to take place in the coming years. However, it would be necessary to carry out **structural reforms in Austria** (including reforms in connection with pensions, fiscal equalization, disentangling competencies, education, home-attendance care, tax structure, state-owned banks). Additionally, among other things, the **macro-economic growth scenario** and the expected noticeable drop in the **expenditure rate** in the most recent stability program are considered to be **too optimistic.**

According to the Council of the European Union, the general government budget plan for Austria in 2013 should **be implemented –** as scheduled **–** so that the sustained correction of the excessive deficit and efforts to make structural adjustments according to the Council recommendations in the framework of the Excessive Deficit Procedure will be achieved. After correcting the **excessive deficit, efforts to make structural adjustments** should be made **at a suitable speed** in order to achieve the **medium-term budgetary objective of a structural budget deficit of a maximum of 0.5% of GDP (MTO) by 2015;** Aid pacts for banks present a temporary measure and do not alter the course of structural adjustment to the extent that they do not have a negative influence on funding costs for the public debt.

From the **point of view of the Government Debt Committee** consistently implementing the planned consolidation course in the most recent stabilization program and the existence of resolution plans for nationalized banks in Austria will pave the way to discontinuing the **Excessive-Debt Procedure against Austria**. Also in this way compliance with the **federal debt brake (national fiscal rules according to the Austrian Stability Pact 2012)** and with the multi-dimensional **EU-Fiscal Rules** (mainly the six pack) could be achieved to the **greatest possible extent**, even though, from the present point of view, the structural adjustment course does not seem to be ambitious enough.

The “stimulatory measures of the federal government”, which were resolved in June 2013 for 2013 to 2016 are in the range of up to EUR 2.0 billion (including residential housing development, expanding child-care and home-attendance care services, bringing forward flood-control projects, loans provided by the ERP Fund as flood-related aid) and they are to be financed by various public budgets. Information on the definite organization and implementation that is needed for a precise assessment of the effects on the consolidation path has not yet been presented.

Restructuring **nationalized banks and** carrying out **statistical revisions** (transition to ESA 2010) will cause changes in the consolidation path included in the present stability program until 2017.

Recommendations of the Government Debt Committee

On the backdrop of the persistent financial and economic crisis, the high public debt, the Union rules on budget discipline and in consideration of the current expected economic framework conditions **for 2013 and the medium-term budget path, the Government Debt Committee recommends the following**:

- To **consistently continue the moderate consolidation course** that has been pursued since 2011 in spite of the weak economic period and upcoming elections. It seems possible for the planned balanced budget to be achieved by 2016, but it will require sustained budget discipline and a focus on stability by all economic decision makers. The extremely low interest rates on Austrian government bonds show the trust placed on the domestic economic strength. Austria is included in the group of particularly stabile countries in the euro area.

- To allow **cyclical revenue and expenditure changes** in the budget (automatic stabilizers) to **take full effect**. **Discretionary employment-policy measures** as well as stimulus programs should be limited in time; compliance with the planned consolidation path according to the recent stability program must in no way be compromised and must be counter-financed by reallocating budget funds to the extent possible.

- To give **budget consolidation priority** over any **tax reductions** and **expenditure increases** (especially new grants) in the coming years. **Tax reforms** should lead primarily to structural changes and focus on **relieving** the **factor labor in Austria** and **simplifying** the **taxation system**.

- To ensure **stronger coordination** of the **consolidation course** with the **reform program** of Austria on the **EU-Strategy "Europe 2020"** (employment, research and development, climate change, education, poverty reduction). **Integrated strategies** of this type combined with cost-benefit considerations (which are as much quantitative as possible) while taking into account the EU Structural Funds would **strengthen** the **effectiveness** of public budgets, the **quality of budget management** and the medium-term **governance architecture** according to the Federal Budget Act 2013 and **by means of coordinated information** (mainly a strategic report, a budget report, an effect-monitoring report**)** **clarify** the **reform program** of the federal government for the public.
- To call for **comparable medium-term budget plans** with (quantifiable) reform programs of the **provinces and municipalities** according to uniform principles in order to attain a sustainable consolidation path and to define more precisely open **structural reform plans** on the **federal level**, (e.g. in connection with grants and health care). Measures must be taken mainly in connection with grants, to ensure more transparency in order to avoid, among other things, double funding. Consolidation steps should be taken in those areas in which there may be efficiency reserves to tap and the steps should be organized in a manner that they support the sustainable budget path. The **national medium-term financial plan** with **quantified measures** of the **individual government levels** (Art 4 EU-Regulation 473/2013 – two pack) is to be submitted to the European Commission by the end of April 2014.
- On the backdrop of the **new budgetary law of the federal government** (Bundeshaushaltsgesetz 2013) and the **upcoming legislative period**, to **adapt the organizational structure of the federal government** in a manner that avoids overlapping legal competences and diverging targets of various ministries and to pay more attention to the **basic principle of transparency**, which is **laid out in the constitution** (Art. 51 Federal Constitutional Act (Art. 51 Bundes-Verfassungsgesetz)). In keeping with this, documentation of the budget estimate should be prepared in a more reader-friendly way. Also **government reports for the Federal Assembly** (e.g. according to § 6 of the Financial Market Stability Act (Finanzmarktstabilitätsgesetz) or § 4a of the Balance of Payments Stabilization Act (Zahlungsbilanzstabilisierungsgesetz)) should be made available to the **public,** provided that there are not any special interests in confidentiality involved.
- To legally anchor the processing of statistics on **enterprises** and **municipality associations with close ties to the government** (organizations monitored by regional and local governments according to ESA), which for the most part provide **infrastructure** in Austria as part of the amendment process on the **Government Finance Statistics Regulation** (Gebarungsstatistikverordnung). Information on **assets and liabilities**, **public transfers**, **net borrowing**, and on **guarantees** of state-owned enterprises toward third parties as well **as personnel capacities** are relevant for efficiency and credit assessment analyses as well as for strategic risk controlling of provincial and local governments. Several such parameters (including debt level, guarantees) are, in any case, to be recorded according to the EU Directive on National Fiscal Frameworks starting with 2014. In addition, but avoiding duplicity, reports on spin-offs would be necessary, not only on the federal level, but also on the provincial and local level.
- To include **fundamental policy decisions** concerning **competence and structural reforms** (federalism reform) **applying to all levels of government,** including the areas of administrative efficiency, education, civil-servant pension law, grants, local public transport as well as fiscal competence of the provinces and municipalities, **as priorities** in the **upcoming government program** and to **show determination in implementing them in the next legislative period.** By combining responsibility for tasks, expenditures, and funding for public services such as **education, child care, health care and social benefits on one certain level of government**, not only could incentive mechanisms for budget management and efficient fulfilling of tasks be strengthened and the pressure for consolidation be lowered, but also simpler structures that reduce transfer interrelations

could be put into effect.

- To push forward with the reform process for a basic new **overall architecture for fiscal equalization** by determining the **main objectives and principles on the political level** and in doing so to reinforce **self-responsibility** by reducing mixed-funding forms and strengthening the **responsibility of the provinces and municipalities in connection with revenues**. The new fiscal equalization system should be implemented at the latest by the end of 2016 and from the point of view of the Government Debt Committee the principles of **fiscal equivalence** (agreement of beneficiaries and the bearers of the costs) as well as the **connection** (combining of responsibility for tasks, expenditures, and revenues) should follow.

- **On a sub-national level,** to implement organizational improvements as well as **budget systems compatible with the new Federal Budget Law 2013** (**Bundeshaushaltsrecht 2013)** (including integrated operating statement, cash flow statement and statement of financial position) and **eliminate existing regional divergences**. For an effective overall steering of financial policies and for the implementation of important plans in Austria, meaningful and comparable information on the budget situation, the medium-term development of the budget, the net asset position and on contingent liabilities of all provincial and local governments is required. In this connection a comprehensive reform of **Budgeting and Accounting Regulations** (Voranschlags- und Rechnungsabschlussverordnung) with **binding accounting requirements** is urgently needed.

- To make the **regulations (valid since 2012) concerning maximum guarantee limits** of the federal government, provinces, and localities more restrictive, uniform and transparent and to integrate them in a strategic and ongoing risk management system. The financial and debt crisis has shown that explicit and implicit guarantees may unexpectedly come into play on a large scale. From the risk point of view, the differentiation between **guarantees** (e.g. EFSF), **strategic holdings** (e.g. participation capital, ESM, infrastructure companies, banks with provincial liability) or other **strategic investments** (e.g. granting loans) is unclear. Laws on guarantee limits support a comprehensive risk management but cannot replace it.

- To legally incorporate risk-averse, comprehensive and specified **standards** (including recording standards, reporting requirements, and transparency) for **investment and funding operations** of the **provincial and local governments** and of **enterprises with close ties to the government** that have been assigned **public-service** duties.

- To make use of the present extremely low interest-rate level for **long-term funding** with **a fixed interest rate** on all levels of government.

- On the **European level** to make a contribution so that balancing public budgets, creating suitable framework conditions for more growth and employment and also strictly implementing measures to stabilize financial markets and banks, which guarantee fair competition, will **effectively complement another**. The **measures required** to resolve the public debt crisis and also the labor market crisis **must be put into effect,** 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

The following EU regulations for Austria are valid to the extent that there are no exceptional occurrences (as, for example, natural catastrophes, serious recessions):

- As long as the **structural budget deficit of the general government** has not reached the national medium-term budgetary objective (MTO) (the cyclically-adjusted budget balance not including one-off and other temporary measures) **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 light of **a process due to an "excessive deficit"** (ED Procedure), Austria has the obligation
    - to reduce the deficit rate to **below 3% of GDP by 2013,**
    - to **reduce** the average, **structural budget deficit by 0.75% of GDP** in the years 2011 to 2013 on an annual basis and
    - to achieve a reduction in the debt rate.
- 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 with 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**.
- **Transposing EU requirements into national law** and **limiting the medium-term budgetary objective** in a legally binding, permanent way to a structural budget deficit of a maximum of 0.5% of GDP on the basis of the **"Fiscal Compact"** (Treaty on Stability, Coordination and Governance in the EMU). In addition, member states must set up an **automatic corrective mechanism**.

Fiscal EU requirements were transposed into Austrian national law by means of the **Austrian Stability Pact 2012**, which became effective **retroactively** at the beginning of 2012 – for the province of Salzburg at the beginning of 2013. 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 security funds: 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 up to 1.6% of GDP. A debt brake has not been incorporated in the Austrian constitution.