Main Results of the Austrian Report on Public Finances 2003[1]

Economic Framework, the Fiscal Position of the Public Sector and the Federal Government's Debt Activities in Austria in 2003

Economic Framework and the Fiscal Position of the Public Sector in Austria in 2003

- In the year under review, 2003, it was still not possible to overcome the economic stagnation which has continued since 2001. In 2003, the **Austrian economy** grew by a real ¾% (2002: +1.4%) which was at the same rate as the average of the EU 15 and more rapid than in the euro area (+0.4%). Europe's economic recovery was made more difficult through the weak internal demand, along with a rise in the savings ratio as a result of the population's increased insecurity faced with the strained situation on the labour market, as well as consolidation efforts (e.g., pension reforms) being undertaken in public budgets, and the strong euro.

- The interest rate development, once again, displayed a declining tendency: the three-month interest rates on the **money market** (EURIBOR) were 2.8% in January, reaching their lowest level in July (2.1%) before increasing slightly in the following months (December 2003: 2.15%). The rates on the capital market displayed a similar tendency although the increase in interest rates was more pronounced in autumn 2003 than it was on the money market. The **secondary-market yields for Austrian government bonds** (10 years) were, on the yearly average, below the value of the previous year by 0.8 percentage points and, in 2003, lay at 4.2%. The difference between the ten-year interest rates and three-month interest rates amounted to 185 basis points (2002: 165 basis points) on the yearly average.

[1] Source: Staatsschuldenausschuss, Bericht über die öffentlichen Finanzen 2003, Vienna 2004 (English version of chapter 7).

- **The current results for the developments in Austria's public budgets** (as of March 2004), for the year under review, confirm the expansion of the budget deficit of the general government, which was already depicted in the Austrian stability programme at the beginning of 2003. After a budget deficit in 2002, amounting to 0.2% of the GDP, it appears likely that, in the year under review, the budget deficit for the public sector will reach 1.3% of the GDP. Here, attention must be drawn to the fact that the data available for 2003 is still provisional and, especially in the area of communal activities, based on estimates.

- In 2003, the deterioration of the budget balance of the public sector was principally the result of the **weak economic performance**. However, this was also partially due to other influential factors such as increased budgetary expenditure and reduced revenues which could only partially be compensated for by the continuation of the consolidation programme. **Individual aspects which characterized the developments in public budgets in 2003** follow:

- In 2003, **taxation revenues** were extremely dampened mainly because of the continuing, unfavourable economic situation but also due to special effects. The total taxation revenue of all government levels sank slightly and was 0.4 billion euros lower than in the previous year (taxation revenue 2003: 62.9 billion euros; 2002 and 2001: 63.3 billion euros). There were significant decreases in direct taxes and here, in particular, in the **income and corporate income taxes.** The low revenue from direct taxes was partially the result of special effects, including tax relief resulting from the two **economic packages** of the year 2002, assistance for the victims of **summer 2002's catastrophic flooding,** payments resulting from the annulment of **taxation on accident pensions** as well as a **decline in taxation assets** (Steuerguthaben). The government's revenue from the **value-added tax** also stagnated whereby the reform of the **import value-added tax** also had an effect. In total, in 2003 the year under review, there was a slight increase in taxation revenues, on the federal level, amounting to 0.1 billion euros, compared with the previous year, whereas the taxation revenues of the states and municipalities showed a slightly declining tendency of -0.2 billion euros, in both cases.

- The strained situation on the labour market (a further increase in the number of unemployed) required increase governmental budgetary means being made available on the expenditure side to support the **services of the unemployment insurance** (+0.3 billion euros or +11.2%) and also resulted in additional expenditures for **social insurance** (social assistance) on the part of the states and municipalities. In 2003, the ASVG-pensions (general social security system) were increased by an average of 2.0% (0.5% pension increase, 1.5% compensation for loss of value) which lay above the inflation rate. There was a marked increase in the **federal government's contributions to the pension insurance** (+1.0 billion euros or +17.8%) whereby this increase was partially due to the cessation of previous payments from the Labour Market Service (AMS) to the social security funds.

- In addition, the **federal government** was faced with **additional expenditures** particularly for **measures taken in family politics** (claims on benefits for childcare, increase of financial support for families as of 1 January 2003; expenditures from the sharing fund for family burdens: + 0.4 billion euros or 7.7%) and through increasing **personnel costs**. The increase in pensions, as well as the increase in the number of people retiring, increased the federal government's obligations for the pensions of civil servants and the teachers of the states by a total of 0.2 billion euros or 6.4% whereby, in particular, the pension payments to the states' teachers showed an expansive tendency (+0.1 billion euros or 12.2%). The number of civil servants going into retirement almost doubled in 2003, compared with the previous year, to 6,987. The costs for active, federal civil servants (employees' remuneration according to ESVG) showed a somewhat more dynamic development in 2003, than in the year before (2003: +0.2 billion euros or +2.5%; 2002: +0.1 billion euros or +0.8%), due to a salary increase (+2.1% or a minimum of 30 euros per month). One positive aspect must be mentioned – the federal government continued its plan of significantly reducing the **level of personnel** and, in the year 2003 (31.12.2002 to 31.12.2003), lowered this item by the full-time equivalent of 4,069 employees (192 of these through spinning-off (museums)). In addition to strict budget implementation, reductions in interest repayment for debts, which amounted to 0.3 billion euros or 4.4% less than in the previous year, also played a reductive role.

- Additional costs at all levels of the government were the result of measures taken to eliminate the damage to the infrastructure caused by the **catastrophic flooding which occurred in summer 2002** and which, in part, were only implemented in 2003.

- The reduction of the **tax share** as a result of the weak development in taxation revenues appears to have played a particularly decisive role in the diminishing of the financing surpluses of the **states**. On the expenditure side, **additional costs for social services** as well as **increasing costs for health care** had a major effect. In addition, **promotion of the economy** was supplemented and **investment activities** – particularly in view of the increased responsibilities in the area of road building – were accelerated. Savings principally resulted from the strict **reduction of debt** and the ensuing decline in the interest burden (abetted by the generally low interest rate level), through **a moratorium on hiring new personnel in some states** (continued in Tyrol and Salzburg, introduced in Styria) as well as, to a lesser extent, through spinning-off (e.g., the State Conservatory in Vorarlberg). Further, the path taken of selling claims for loans on housing and using this to repay debts, and/or create reserves was continued (Styria). The contributions of the states (including Vienna) to the financial balance of the general government amounting to 0.75% of the GDP or 1.67 billion euros, agreed on within the framework of the **inner-Austrian stability pact**, appears, on the basis of the provisional information available, to have not been entirely reached at the end of 2003.

- The **municipalities** were also confronted with a slight reduction in taxation revenues in 2003, compared with the previous year. This basically reflects the declining share of municipalities in those federal tax revenues that are subject to fiscal sharing. The growth in expenditures was substantially determined by the **expansion of transfer payments** (in the areas of health and social services) and also through a considerable increase in **personnel expenses**. One reason for this increase in personnel expenses could have come as a result of the establishment of additional centers for childcare and an increase in the number of personnel in the health and social areas (in particular, in old-age and nursing homes). In addition, there were also changes in connection with the **scope of municipal expenditure**: in the year under review, passport and lost-and-found activities were transferred to the municipalities (1st February 2003). However, it appears that the **municipalities' stabilisation contribution** (balanced budget) was reached for the year 2003. In order to reach this goal, it appears that investments were postponed or were made mainly in the areas of enterprises with market-determined activities (spun-off entities). The budgetary result appears to have also been positively influenced by an intensification of cooperation between the municipalities (central purchasing, real-estate and debt management) as well as through an increased use of alternative forms of financing.

- In an **international comparison**, it can be seen that Austria's fiscal position did not deteriorate in the year under review in spite of an increase in the deficit. After Austria had managed to keep its budget balance close to zero in 2001 and 2002, the budget deficit rose to 1.3% of the GDP in 2003, but still lay considerably below the 3% ceiling of the Maastricht treaty and also considerably below the average in both the euro area (-2.7% of the GDP) and the EU-15 countries (-2.6% of the GDP). Only Finland (+2.3% of the GDP), Denmark (+1.5% of the GDP) and Sweden (+0.7% of the GDP) had high budget surpluses.

- Additional attention must be drawn to the fact that, in the year 2003, important **structural reforms** were initiated which will contribute to the consolidation of public budgets over the coming years. Here, the **pension reform 2003** and the **Austrian Federal Railways reform** play a significant role. In addition, the **first stage of the taxation reform** and the so-called "**growth and location package"** both set measures to improve the attractiveness of Austria as a commercial location and to strengthen employment and the purchasing power of households.

- In 2003, the **total revenue of the general government** amounted to 111.5 billion euros, or 49.7% of the GDP and the **expenditure** 114.7 billion euros or 51.2% of the GDP. A comparison shows that, in 2003, the total revenue of the state was characterized by an extremely low growth rate, even smaller than that of the previous year (2003: +0.4%; 2002: 1.2%). The state's expenditure demonstrated a slightly more dynamic tendency, however, with 2.5%. This was below the average of the past five years (2.7% p.a.). The **tax ratio of the general government** showed a significant decline for the second time in a row (2003: 43.2% of the GDP; 2002: 44.3%; 2001: 45.4%).

- The report shows that more than 60% of the **state's expenditure is used for transfer payments to third parties** (social support for households and subsidies for enterprises), almost 30% for the **public administration** (wages and salaries, material expenses) and approximately 7% for **interest payments** on the public debt. Only approximately 2% of the total expenditure is used for **investments** (gross investments). A comparison of the years 1999 to 2003 makes it apparent that, over recent years, the expenditures for the public administration (material and personnel expenses) have shown a rate of change significantly lower than that for the growth of total expenses, the state's expenditure for "transfer payments" (to households and enterprises) has a more dynamic character and that payments for "interest payments" on the public debt and "investments" often even show a declining progress. In the year under review, this trend was, once again, confirmed. However, the outlay for "material and personnel costs" for the public administration increased somewhat more than in the previous years.

- **Spinning-off** was primarily responsible for the quite-large reduction (an average of –6.1% per annum) in the **public expenditure for investments** in the period under review (1999 to 2003). If the investments for the spun-off enterprises, which formed a part of the government sector in the past, are added to the state's investment, we are presented with the following picture: the gross investments of the state (including spun-off enterprises) stagnated with a volume of around 5 billion euros. At the same time as investments increased on the federal level, the municipalities – even if investments in spun-off organizations are taken into consideration – have significantly reduced the volume of their investments. Communal investments (including spun-off enterprises) declined from 3.1 billion euros (1995) to 2.4 billion euros (2002).

- **Taxes** and **social-insurance contributions** play a significant role, on the **revenue side**, towards financing public expenditure. In total, they make up around 90% of the public sector's revenue. Additional sources of finance for the state are **"production profits"** (payment for services), **"property income"** (interest, dividends, payments for licenses), as well as **"transfers"** (contributions for education, court fees) which, measured as a percentage of the total revenue, are comparatively unimportant. Within this group of so-called "other revenues", "production profits" (mainly, payments for services such as hospital services, nursing homes or communal care institutions) provide the highest contribution to financing, amounting to somewhat above 10%. This percentage shows a sinking tendency due to the spinning-off of cost-effective organizations, with market-determined activities (percentage of total revenue: 1999: 6%; 2003: 4%).

- The **structure of public revenues and expenditures** is depicted in table 12 of this report. It demonstrates that the weighting of the separate governmental levels on the individual revenue and expenditure categories, as well as on the total expenditure and revenue, varies greatly. There are close connections between the four governmental sectors which can be empirically seen in the high volume of **"intergovernmental transfers"**. Although the tax shares of the individual territorial bodies, which are regulated in the fiscal sharing Act, are booked directly as taxation revenue of the individual legal bodies (the recipients), the intergovernmental transfers of the states account for approximately one-half of total revenue and those for the municipalities approximately one-fifth. Especially in the case of the social-security funds, the federal contribution to pensions results in an intergovernmental revenue ratio of more than 25%. If one observes the expenditure side, it become apparent that services, which are then executed by other public bodies (the states' teachers, housing subsidies, federal contribution to hospital financing) are, principally, (co)financed by the federal level. In 2003, the total amount of transfers between the federal government, the states, municipalities and social-security funds was around 31 billion euros with approximately 21 billion euros made up of payments by the federal government.

- Provisional data shows that the **national debt, in accordance with Maastricht,** reached 145.5 billion euros at the end of 2003 – only slightly increasing compared with the figures from the previous year (2002: 145.3 billion euros), in spite of a budget deficit. Measured against the GDP, this shows a reduction of the debt ratio amounting to 1.7% (year end 2002: 66.6%; year end 2003: 64.9%). If one neglects – deviating from the Eurostat assessment – the **intermediary funding of state-owned companies by the federal government** (Rechtsträger), which are classified in the private sector, the debt ratio decreased by around 11 billion euros or 4.8% of the GDP to 60.1% of the GDP. Without this financing of public entities, Austria would have only marginally exceeded the Maastricht ceiling of 60% of the GDP at the end of the year under review.

- The case of financing state-owned entities in Austria (Rechtsträger) shows that, from an economic point of view, a deviation from the EU’s current **gross debt framework** to a **net debt framework**, or at least an extension of the set of indicators to include the net debt, would be appropriate. In view of long-term sustainability it appears that an indicator including financial assets (bank deposits, loan grants, stocks and shares, participations) along with financial liabilities would be more suitable. This kind of net concept, in connection with debt would, in addition, also correspond to the Maastricht definition of deficit, which provides information on the alterations in the net financial assets position of the public sector.

- **To summarize**, it can be observed that, in 2003, Austria’s public budgets continued to proceed on their consolidation course. However, it can be seen that lengthy periods of deterioration in the economic conditions, in particular, place increased pressure on consolidation. On the one hand, this results in increased expenditures (automatic stabilizers) and, on the other, expenditures with an increasing tendency (legally-standardized adjustments, concluded or agreed-on improvements in services and/or the quantity and price effects of public services) can not be compensated for through additional revenue (growth dividend). The result is an increase in the budget deficit. It is true that, in an international comparison, Austria has a low budget deficit. However, additional structural measures appear necessary in order to reach the sustainable goal of having a balanced budget over the complete business cycle. In connection with the “quality” of public finance, it can be observed that the alterations in the revenue and expenditure structure of Austria’s public sector, in the year being reviewed, were mainly the result of the weak performance of the economy. Permitting automatic stabilizers to function, as well as additional taxation relief, at the same time as making additional transfer payments to the private sector, played a role in dampening the marked deterioration in the economic conditions in Austria.

The Federal Government’s Debt Activities and the Creditors’ Structure in 2003

- In 2003, the **federal government debt** (without own security holdings) increased more than in the previous years due to a higher net deficit (2003: 2.9 billion euros or 2.4%; 2002: 2.5 billion euros or 2.1%) reaching a level of 126.9 billion euros at year end. Measured against the GDP, there was, however, a moderate reduction of the federal debt ratio (2003: 56.6% of the GDP compared with 56.8% in 2002). The **share of foreign-currency debt** in the total debt declined, comparatively strongly, from 12.7% (year end 2002) to 11.0% at the end of 2003.

- The debt management of Austria’s federal government took greater advantage of **long-term EUR government bonds** to meet its **financial requirements** than was previously the case. In 2003, more than 90% of new credit (taking swaps into consideration) was in the form of EUR government bonds (2002: approximately 75%). This debt-management strategy was appropriate on account of the historically low nominal interest level and the market situation in the euro area. On the euro financial market, demand is influenced by internationally-active finance intermediaries, who require high volumes and place particular importance on the criterion of “liquidity”.

- The **difference in the yields** of German federal bonds, which have a “benchmark status” in the 10-year period segment, and those of Austria, further decreased in the year under review. In 2003, the yearly average difference to Germany, for 10-year bonds, amounted to only 8 basis points (2002: 18 basis points). Similar developments could be observed in the majority of EMU countries, when compared to Germany, (EMU average 2002: 18 basis points; 2003: 9 basis points – excluding Greece and Luxembourg).

- The **financing activities of the federal government’s debt management** not only include obtaining capital to cover the gross financing requirements of the government (net deficit plus redemption) but also financial operations to control the debt portfolio (portfolio management) in relation to interest procedures and currency structure in order to be able to guarantee the adaptation of the debt structure to the individual conditions on the market as rapidly as possible and to support the controlling guidelines. This condition can be observed particularly in the increase in claims and liabilities from **swap contracts**. In 2003, new debts were not only taken out in the form of currency and interest swaps but also **cross-currency swaps** were used to a greater degree to restructure existing liabilities.

- In 2003, the **structure of the federal debt** in Austria moved further in direction of securitized loans in euros (marketable debts). At the end of the year, 76.2% of the federal debt was in the form of EUR government bonds (2002: 73.0%) and 77.4% of all loans in the form of marketable debts were in euros (2002: 74.3%). The share of credit and loan contracts in euros continues to decrease continuously and, at the end of 2003, only amounted to 11.7% (2002: 13.0%) of the total debt.

- The outstanding volume of **foreign-currency liabilities** was reduced slightly in the year 2003. In addition, once again revaluation gains were attained for the foreign-currency debt (unrealised net gains amounting to 1.1 billion euros).

Both factors resulted in the percentage of foreign currency in the national debt being, relatively strongly, reduced (foreign-currency percentage at year end 2003: 11.0%; year end 2002: 12.7%). The **volume of foreign-currency liabilities** in euros (taking own bonds and currency swaps into consideration) amounted to 13.9 billion euros at the end of 2003, 1.8 billion euros below the value of the previous year (15.7 billion euros).

- The realization of the EMU occurred at the same time as the cessation of the traditional role of Austrian financial intermediaries as the principal investors in the federal debt. In the mean time, **foreign investors** (particularly from the euro area) finance almost 65% of the total liabilities of the federal debt in euros and foreign currencies. At the end of 1998, the state's foreign debt-ratio (liabilities in foreign possession compared with the federal debt (before swaps and including intermediary funding of state-owned entities) was below 40%. Of the government bonds issued in the year under review, amounting to 15.6 billion euros (including 10% own holdings and intermediary funding of state-owned entities) foreign primary dealers took on about 88% (2002: 89%) within the framework of tender proceedings or as a result of syndicate issues. If one also takes secondary market transactions into consideration, foreign lenders purchased 79% of the volume issued by the government in the year under review.

- The historically **low interest rates** in 2003, as well as the given repayment profile (high volume of repayments in the near future) indicated that financing with fixed interest rates, over a lengthy period, should be encouraged in order to keep interest rates low over a period as long as possible and also to keep the refinancing risk (risk of alteration in interest rates) within bounds. At the end of the year under review, 92.8% of the outstanding liabilities of the federal government had a **fixed interest rate** (2002: 91.1%). Financing instruments, with **money-market conditions**, accounted for 4.0% of the federal liabilities at the end of 2003 (2002: 5.1%). The portion of titles with **half-variable or variable interest rates**, whose rates are dependent on the development of **yields on the capital market** (secondary market, primary market) reduced from 3.8% to 3.2%. The average **time to maturity** of the **total debt portfolio** (debt of the federal government including own bonds) rose considerably, in the year under review, for the first time in over fifteen years (1986). At the end of 2003, the average remaining maturity of the outstanding debt was 5.9 years - 0.4 years above that of the previous year.

- The average **nominal interest rate** of the federal government decreased, in the year under review, from 5.0% (year end 2002) to 4.8% (year end 2003) in spite of an increase in the remaining term. This development was principally triggered by the extensive redemption of debt categories with a considerably higher nominal interest rate of up to 8.5%. The further reduction in the level of the market interest rate in 2003 also supported this development but only had a limited effect on the average nominal interest rate of the total federal debt on account of the high portion of fixed interest rates in this debt, lower financing over the money market and as a result of an increase in obligations.

- If one analyses the structure of the federal government's debt with the focus on its **interest sensitivity**, it can be seen that the government's debt management endeavours to have the **interest payments in the budget** follow as continuous a course as possible, by taking particular advantage of long-term fixed-interest debt forms. In the year 2003, the term profile moved towards long-term financing with fixed interest rates, thereby additionally reducing the risk of changes in the interest rate (cash flow at risk) and the risks of refinancing in the coming years. However, it can hardly be assumed that the reduction in the nominal interest rate will, in the future, continue to the extent of recent years seeing that the positive refinancing effect (replacement of the debt categories of the past with a high interest rate by those with a lower rate) is gradually weakening.

- Traditionally, in the reports presented by the Government Debt Committee, a so-called **net concept** is chosen for the **interest payments** (chapter 58 of the federal budget "Financing, currency swap contracts") which includes, along with interest payments, extra expenditures such as issue losses and/or profits (disagio and/or agio) commissions and fees, derived from expenditures, less the income in chapter 58 of the budget. In the year 2003, the expenditure item

interest expenses for the debt was even lower than in the preceding year although the federal government reported net deficits for the years 2002 and 2003 (interest expenses 2003: 6.3 billion euros; 2002 6.6 billion euros). This positive development can be primarily explained by the circumstance that a large quantity of debt categories, with a higher nominal interest rate than is presently the case, became due. If one includes **additional expenses**, the costs for the debt show an additional slight decrease (-0.05 billion euros). In the year under review, the budget item “additional expenses” was, once again, lower than the revenue.

- If one compares the interest costs of the federal government with key-data for the national economy, it can be seen that, on the one hand, **interest repayments** for the federal government’s debt is an important factor in its budget which, however, on the other hand could reduce strain on the budget through the government’s consolidation course and the declining level of market interest rates, as well as through debt-management measures to reduce costs. In this way, in 2003, the **interest repayment ratio** (measured against the GDP) once again declined (2003: 2.8% of the GDP; 2002: 3.0% of the GDP) despite the weak developments in the economy. Interest payments (including extra expenses) however, still bind slightly less than one-fifth (2003: 17.6%) of the net tax revenue of the federal government (budget chapter 52 “public taxation”).