Main Results of the Austrian Report on Public Finances 2001[1]

Economic Framework, the Fiscal Position of the Public Sector and the Federal Government's Debt Activities in Austria in 2001

Economic Framework and the Fiscal Position of the Public Sector in Austria in 2001

- The year dealt with in this report, 2001, was characterized by a distinct decline in the global economy, which was not expected to this extent. The **growth of the Austrian economy** declined after the second quarter of 2001 and reached its low point in the fourth quarter of the same year when it arrived at stagnation compared with the same quarter of 2000. The year's average displayed a real increase in total production of 1.1%. This was the lowest value since 1993.

- In 2001, the **interest-rate development** in the euro area showed a downward tendency, reaching its lowest stand at the end of the year. The three-month-rate on the money market attained its highest value (4.8%) at the beginning of the year and, over the year, sank to 3.3% in December. The ten-year interest rate, which fluctuated between 5.3% and 4.7% in the year reported on, showed an upward tendency – particularly in the second half of the year. The difference between the ten-year interest rate and the three-month rate was approximately 80 basis points, on the yearly average.

- The **budget development in the public sector** shows that – already in 2001, one year earlier than planned – **Austria** reached the targeted budget goal of a zero deficit for the public sector (as of March 2002; in the sense of the budgetary notification). However, the revisions of the budget balance illustrate that this does not represent the final amount. The reasons for this lie, on the one hand, in the fact that there are differences in the availability of

[1] Source: Staatsschuldenausschuss, Bericht über die öffentlichen Finanzen 2003, Vienna 2004 (English version of chapter 8).

administrative budget details and the final results of the budget performance of all public bodies (in accordance with ESA 95) are only made public with a delay of over one year (the final details for the year 2000 did not become available until March 2002). On the other hand, multilateral control procedures lead to questioning those province-specific characteristics and bookkeeping conventions which, in some cases, could make a change in the present bookkeeping practice necessary. However, the information at our disposal makes it clearly apparent that, once again, in 2001, significant progress was achieved in the consolidation process (budget balance 2001: +0.1 billion euros or +0.1% of the GDP).

- The **sectoral distribution of the budget balances** in Austria's public budgets shows that, in 2001, the consolidation process was implemented in all sectors. The deficit of the federal sector was reduced from 1.6% of the GDP in 2000 to 0.6% in 2001. The excess of the provinces and communities apparently increased from 0.2% of the GDP in 2000 to 0.7% in 2001. Based on current information, it seems likely that the budget balances of the social security funds have also improved slightly (2000 –0.2 billion euros; 2001 –0.1 billion euros).

- The following **influential factors and reform steps** played a particularly important role in the improvement of the budget balance:

- In spite of the unfavourable economic situation, **tax yields** demonstrated an extremely dynamic development. Here, the comprehensive measures taken in regard to taxation, which were included in the consolidation packages for 2001 and 2002, played an important role as well as the fact that economic influences, due to temporal delays in tax assessment and in the developments on the labour market, distributed over two or three years, affected taxation success. Among the changes in taxation laws, interest on taxation arrears (claim taxation) and the increase in prepayments for income and corporate taxes, led to an increase in revenue considerably above the federal draft budget.

- The federal government, the provinces and communities introduced an **inner-Austrian stability pact,** backdated to 1 January 2001. Agreement on its principles was reached during the fiscal sharing Act for the years 2001 to 2004. This contract guarantees, through defined limits to the budget balances for the years 2001 to 2004 and agreements on sanctions, that, in a joint operation, a balanced budget, in agreement with EU criteria, will be reached for the years 2002 to 2004. However, temporary, minor shortfalls are permissible without sanctions being taken.

- The federal government's **consolidation packages for 2000 and 2001** foresaw measures to slow down the developments in the spending of the government and the social security funds. Here, it is necessary to draw particular attention to the pension reform 2000 and measures in the area of the public administration, which include an increase in personnel and budget controlling. In addition, the increase in the salaries of civil servants was limited to 500 schillings (36.3 euros) in 2001.

- In comparison with the previous year, the considerable budget excesses of the **provinces and Vienna** (the ESA counts Vienna as a community) were the result of targeted changes in subsidies, hiving-off and a restrictive budget implementation. In order to finance housing projects, for the repayment of debt, as well as for obtaining financial resources, advantage was taken of using reserves and exploiting loans (sale of housing loans to intermediary financers) without having any negative influence on the Maastricht budget balance. In addition, individual entities, in line with the market, such as hospitals, were hived off and provincial real-estate companies (LIG) founded.

- The communities' practice, followed since 1997, of hiving-off organizations in line with the market (defined by the ESA) including water supplies and sewerage treatment, garbage disposal, housing, congress houses, etc., was continued.

- Whereas, in the past, the EU recommendations on the budgetary policies of its member states were concentrated on satisfying the **indicators** on budget discipline included in both the Maastricht treaty and the stability and growth pact, recently, an increase in efforts made on the **revenue and expenditure structure of public budgets**, leading to an improvement in “the quality and sustainability of public finances”, has been observed.

- The increase in the total expenditure of the state was slightly below that of the nominal GDP growth, leading to a moderately declining development in the **government expenditure ratio** (2000: 52.8% of the GDP; 2001: 52.5%). This development is particularly encouraging seeing that, in the previous year, the expenditure volume was lessened through the profits obtained from the sale of UMTS licenses, amounting to 0.8 billion euros or 0.4% of the GDP. In 2001, the noticeable improvement in the budget balance was principally the result of the dynamic development in taxation yields which, partially, were considerably above the estimates in the budget proposal. This led to a considerable increase in the **taxation ratio** (2000: 44% of the GDP; 2001: 45.9%) as well as in the **national revenue ratio** (2000: 51.2% of the GDP; 2001: 52.4%). However, taxation resulting from direct levies was atypically high in 2001 as a result of special effects (prepayment, interest on arrears, etc.).

- This report shows that approximately 60% of **total public expenditure** is used for transfers to third parties (social services to private households and subsidies to enterprises), around 30% for public administration (wages and salaries, material expenses) and about 7% for the payment of interest on the national debt. A mere 3% was given out for investments (gross investments). The slight importance of, and the permanent decrease in, public investments in Austria has, primarily, statistical reasons – namely in a form of “escaping from the budget”. However, specific investigations have shown that the decrease in the budget deficit was coupled with a reduction in investment activities. On the **revenue side**, taxation and social contributions play an important role in financing public expenditure. In total, they cover around 88 to 90% of the total public income. Even though there are more than 100 kinds of taxation in Austria, ten of these categories account for approximately 90% of direct and indirect taxes.

- The **federal structure of public revenues and expenditures** demonstrates that the weighting of the specific government levels on the individual income and expenditure categories as well as on the total income and expenditure, varies greatly. There are close interconnections between the four individual sectors of the state, demonstrated empirically by the high volume of **“intergovernmental transfers”**. Even though the tax proportions of the individual communities, which are regulated in the fiscal sharing Act, are booked directly as taxation income for the individual legal entity (the recipient), the intergovernmental transfer income of the provinces amounts to approximately one half, and that of the communities one fifth, of the respective total income. In particular, the government’s contribution to pensions leads to an intergovernmental income ratio of more than 25% for the social security funds. If one investigates the expenditures, it becomes apparent that, essentially, the government finances services which are performed by other public authorities (e.g., teachers in the provinces, housing support, federal contributions to hospital financing).

- The **Austrian national debt (in accordance with Maastricht)**, in absolute figures, for the year under review, will have been reduced – for the first time since 1997. Preliminary figures indicate that, at the end of 2001, this will total 130.1 billion euros, lying approximately 0.2 billion euros below the comparative figure for the previous year. Of this sum, 119.7 billion euros (92%) apply to the federal level, 9.4 billion euros (7.2%) to the provinces and communities and 1 billion euros (0.8%) to the social security funds. The declining tendency in 2001 is the result of measures taken in the provinces, including Vienna, on the assets level. In addition, the federal financial requirements for 2001 were lower than the Maastricht-budget balance. At the end of 2001, the debt ratio for the state as-a-whole amounted to 61.7% of the GDP (2000: 63.6%).

- **Summarizing**, it can be established that notable progress was obtained in the area of consolidation, in the year under review 2001, and that the expenditure and revenue development of the public sector in Austria was strongly characterized by discretionary measures as well as institutional changes. In connection with the “quality” of public finances, the existing results signal – in addition to the expected economic and budgetary implications, which come as a result of shifts in the population structure – challenges in connection with the taxation ratio, the course of gross investments as well as the budgetary development of hived-off entities. A strengthening of those elements in the Austrian public budget which affect employment and growth hardly appears realizable without further reform steps being undertaken in the area of public administration leading to a disentanglement of competences and funding responsibilities.

The Federal Government’s Debt Activities and the Creditors’ Structure in 2001

- The **federal debt** (excluding own security holdings) increased by 0.7 billion euros (0.6%) in 2001 reaching the amount of 121.4 billion euros or 57.6% of the GDP (2000: 120.7 billion euros or 58.9% of the GDP) at year end. The **percentage of foreign-currency debt**, at the end of 2001, amounted to 13.3% (2000: 13.9%). The federal debt constitutes more than 90% of the total public debt, in the Maastricht sense. Data on the structure of the federal debt, therefore, provides important indications of the financing structure of the total public debt in Austria.

- The **financing activities of the federal government**, in the year 2001, can be described as being lively, in spite of a slight increase in debt. They are brought into play, more and more strongly, to fine-tune the debt portfolio (portfolio management) and are not merely limited to covering the necessary capital requirements. This is particularly apparent in the increase of claims and obligations from swap contracts and also in the, relatively high, conversion volume as well as in the dynamic development of the asset portfolio for sovereign debts. The implementation of swaps increases the flexibility of debt management (adjustment of the debt structure in respect to interest and exchange-rate developments, taking advantage of arbitrage possibilities and steering the average length of capital commitment). At the end of 2001, the commitments from cross-currency swaps had reached a nominal volume of

13.5 billion euros (2000: 10.9 billion euros) and the nominal vale of interest-rate swaps amounted to 16.3 billion euros (2000: 8.4 billion euros).

- In 2001, **new borrowing** occurred principally in the form of EUR government bonds. In this case, the increase in obligations led to an increase in the outstanding volume of Austrian government bonds in order to keep the difference in interest to the “benchmark obligations” in the euro area, as low as possible. At the end of 2001, EUR government bonds accounted for 70.4% (2000: 66.1%) of the debt of the federal government. The gap between the interest in Austria and in Germany decreased in the year under review. After an increase in the difference between the interest on Austrian government bonds and those of Germany, in a ten-years segment, to more than 30 basis point in the previous year, there was a decrease – particularly in the second half of 2001 – reaching 20 basis points in December 2001. Similar developments could also be observed in most of the other EMU countries.

- In the year under review, the determining monetary factors spoke in favour of giving priority to financing with fixed interest rates and over a long-term in order to maintain the relatively low interest costs for the longest duration possible. The **actual amount of government bonds with a fixed interest rate** (taking interest-rate swaps into consideration) increased by 5.6 billion euros, or 5%, whereas the obligations with a flexible interest rate (including half-variable interest) were decreased by 3.7 billion euros, or 22.6%. At the end of the year under review, 90.3% of the remaining obligations of the federal government were subject to a fixed interest rate. The **average remaining maturity of the total debt portfolio** (the federal government’s debt) lay, with 5.5 years at the end of 2001, below that of the previous year (5.8 years).

- The average **nominal interest** rate for the **federal debt** decreased, in the year under review, from 5.4% (at the end of 2000) to 5.2% (at the end of 2001). This development was the result of comprehensive repayments of debt categories with a considerably higher nominal interest rate. The decrease in the level of market interest rates in 2001, had hardly any effect on the nominal interest rate of the debt of the federal government due to the high portion of the debt with fixed interest rates, a lower level of financing over the money market, and as a result of the increase in bonds.

- Compared with the previous year, it was possible, in 2001, to reduce the **interest** on the debt (without the expenditure category “other expenses”) by 0.2 billion euros, or 3%, (2000: +0.1 billion euros or +1.8%) thereby arriving at a sum of 6.6 billion euros. In addition, the item “other expenses” decreased the total amount of the federal debt by 0.1 billion euros. In respect to the GDP, the interest repayment (including “other expenses”) was 3.1%, after 3.4% in the previous year. The lower level of new debts (deficit), the fact that a large number of debt categories with a considerably higher nominal interest rate than the current level became payable, and debt management activities to restructure the debt, all played a major role in this downward development.

- The realization of the EMU occurred at the same time as the discontinuation of the traditional role taken by domestic financial intermediaries as the principle investors in the debt of the federal government. Since the introduction of the EMU, the purchasers of government bonds, denominated in EUR, have, almost exclusively, been foreign primary dealers (banks) who place these papers aboard (chiefly in the EMU area). This development supports the diversification of the circle of investors in Austrian government bonds and, at the same time, is indicative of a dynamic development in the **foreign debt of the federal government**. At the end of 2001, 54.0% of the federal government’s EUR obligations were already in foreign possession (at the end of 2000: 47.6%). The total foreign debt of the federal government – taking foreign currency obligations which are, traditionally, in foreign hands, into consideration – reached a quota of 58.6% (at the end of 2000: 52.8%).

- If one analyses the structure of the federal government’s debt, in respect to its **interest sensitivity**, one observes, on the whole, that the federal government’s debt management is targeted at allowing interest payment to run a continuous course, although the shift in the term profile towards medium-term financing implies a somewhat higher risk of changes in interest as a result of refinancing in the coming years, through a stronger implementation of long-term fixed interest forms. However, this orientation stressing the stability factors of debt management, which is supported, in principle, by the Government Debt Committee, can also be disadvantageous. Portfolios, with a longer duration (key figure for average capital commitment, taking interest and redemption flows into consideration) are robust in regard to the variability of interest costs but, at the same time, sensitive in respect to their market value. The market value increases in importance as a result of an active portfolio management (see the recommendation of the Government Debt Committee dated 14 December 2001). The importance which the portfolio's market and/or cash risks should have in debt-management orientation is a topic of international discussion and appears to be, primarily, dependent on the extent to which an active control of the structure of the portfolio is striven for.