The Government Debt Committee and its Recommendations in the 1990s[1]

1 Changes in the Emphasis of the Recommendations

The Government Debt Committee, which has existed on a statutory basis since 1970, and has been headed and formed by Professor Frisch for more than two decades, has the principal task, in addition to providing an analysis of capital markets and the development of financial debt, of making recommendations on the debt policy. Since the beginning of the 1990s, there has been a notable change in the objectives (and possibly in the audience).

In the seventies and eighties, the Government Debt Committee restricted itself, almost completely, to dealing with debt management. This period has already been thoroughly investigated (Mooslechner 1991). Fiscal policy was, to a large degree, not considered in the recommendations. Those expenditures, which had to be financed from the federal budget, were considered as being predetermined to a certain degree.

This picture changed in the nineties in such a way that the recommendations made concerning fiscal policy took on a major role. The Government Debt Committee recommended that the government continue on its consolidation course. This alteration in the target of the recommendations made has occurred, not least, in connection with the international changes in fiscal policy.

The European Union has now stipulated extremely precise limits for outstanding government debt and annual new debts. The budget balance has taken on an increased importance in the evaluation of financial policy. In the treaties agreed on in Maastricht (1991) and Amsterdam (1997), the European Union set exact goals for

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[1] Lehner G., 2002, Der Staatsschuldenausschuss und seine Empfehlungen in den Neunzigerjahren. In: Chaloupek G. et al: Ökonomie in Theorie und Praxis, Heidelberg (English translation).

new debts (a maximum of 3% of the nominal gross domestic product) and for the level of debts (a maximum of 60% of the GDP).

The recommendations, therefore, have two different goals and are aimed at two different audiences. When dealing with fiscal policy, the Government Debt Committee basically takes on the role of an “admonisher”. The recommendations are restricted, to a large degree, to the budget balance (budget consolidation in general) and hardly deal with the structural questions of the revenue and expenditure in the national budget.

Recently, the Government Debt Committee has increasingly called for a coordination of the budget policies of the individual regional administrative authorities. In this respect, it takes the tendencies and demands resulting from the European Stability and Growth Pact, into consideration, seeing that the mentioned targets and balances always consider the public sector as a whole. The division between federal government, provinces and communities is entirely an internal – an inner-Austrian – matter. In addition, the Austrian Federal Finance Agency can also now take care of the debt management of the provinces. At this stage, however, we are not yet capable of assessing which effects this expansion will have on future recommendations.

In contrast to the recommendations made concerning fiscal policy and budget balance developments, those recommendations dealing specifically with debt management have increased considerably in importance. Here, it is possible to check whether these recommendations have been included in the current administration and how they reflect the developments in the national debt.

This contribution attempts to analyse the recommendations of the 1990s without, however, primarily dealing with the judgement of individual recommendations, but with the tendencies which should be emphasized[1].

This paper sketches the importance of the recommendations made by the Government Debt Committee since 1990 (in the nineties), whereby the investigation is undertaken from two points of view.

Firstly, an attempt is made to describe the background and

secondly, as described, the extent to which the recommendations have been put into practice.

The recommendations can be organized into four categories.

1. Recommendations concerning fiscal policy,
2. Recommendations in respect to the distribution of ownership of the debt,
3. Recommendations on the term of the indebtedness and
4. Recommendations concerning the fixed and/or variable interest rates of the outstanding government debt.

2 The Changed Approach to Fiscal Policy

The Maastricht treaty set quantitative limits, for the European Union, for annual new debts and the level of indebtedness, which were subsequently included in the European Pact for Stability and Growth. This resulted in an international change in fiscal policy in the nineties. The consolidation (reduction) of new debts, and a decrease in the level of debt (measured against the nominal gross domestic product), forms a central point in the financial policies of most European countries.

Although annual new indebtedness, and its restriction, stands in the foreground of budgetary policy, seeing that sanctions must be reckoned with should this exceed a limit of 3%, the outstanding amount of the debt must not be ignored, even if this is not interpreted as strictly. As a rule, a noticeable decrease in the debt ratio (a tendency in the direction of 60% of GDP) is sufficient. Here, it must be taken into consideration that, in the first half of the 1990s, a number of members of the European Union had a ratio considerably above the 60% mark and, had the stipulations for admittance to the third stage of European Economic and Monetary Union (after 1997) been strictly enforced, would not have met these requirements.

In contrast to new indebtedness, an excess in the debt ratio is not threatened by sanctions. However, this quota (this targeted amount) must not be disregarded. It is, in particular, an important indicator for the evaluation of financial markets. In the nineties, the Austrian public debt ratio increased to over 60%. This increase was particularly considerable in the first half of the nineties. Therefore, efforts also had to be made to change this trend, lower the ratio to 60% and stabilize it.

This makes the connection between debt management and fiscal policy apparent. This is a major reason for the great interest shown by the Government Debt Committee in fiscal policy and the increasing importance of its recommendations made in this connection. In addition, the expenditure required for the interest payments on the public debt increased dramatically during the nineties, constricting the scope of the budget and leading to a considerable increase in new indebtedness. Fiscal policy and debt management are, therefore, closely linked with each other.

The development of the debt ratio is determined by two components:

Firstly, the relationship between the average interest rate for the debt and the development of the nominal gross domestic product and

secondly, the primary balance of the budget (this is the equivalent of the administrative budget balance less interest expenditure). The interest expenditure is determined by the level of the debt (of the previous year) and the average interest rate.

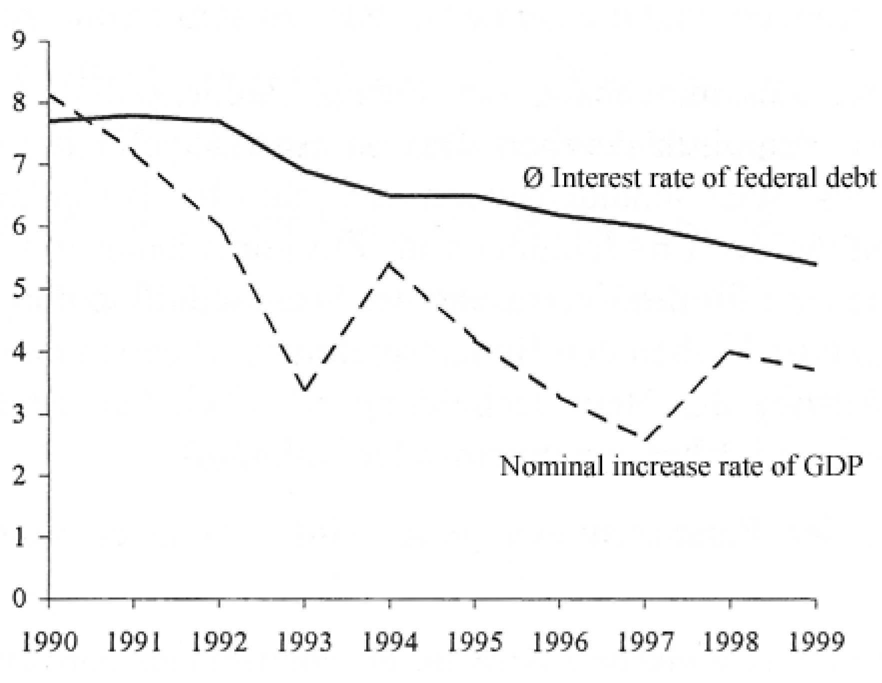
If the primary balance is stable (zero), the interest expenditure is the sole determinant for new indebtedness. Since the level of the debt (t-1) can no longer be influenced (is predetermined) under these circumstances, new indebtedness is solely dependent on the average interest rate. If this is higher than the nominal rate of growth of the gross domestic product, the debt ratio will increase.

If the average interest rate for the debt lies higher than the nominal growth rate of the gross domestic product, a surplus in the primary budget will be necessary to stabilize the debt ratio or even decrease it. If the nominal gross domestic product increases more strongly than the average interest rate, the leeway for the primary budget balance will increase; i.e., even if there is a loss, a stabilization (or decrease) in the debt ratio will be possible.

This leads to the conclusion that considerable connections exist between fiscal policy and debt management, since a primary surplus can remove pressure from debt management. This is the reason for the Government Debt Committee dealing with budgetary problems to an increasing degree.

The development of both the relationship between the average interest rate and the nominal gross domestic product on the one hand, and the primary budget balance of the federal government on the other, makes one understand the increasing concern shown by the Government Debt Committee vis-à-vis fiscal policy.

Fig. 1: Interest rate of the federal debt and increase rate of the GDP in %.



Source: Government Debt Report 1990/1999; Statistik Austria.

Since the beginning of the nineties, the average interest rate for the Austrian federal debt has been higher than the average increase in the nominal gross domestic product (figure 1). The differences, however, vary greatly. On average, the difference is more than two percentage points. In spite of a sinking interest rate level, it expanded considerably in recent years (1995/1997) from 1.2 percentage points in 1994 to 3.2 percentage points in 1997, and only decreased in the past years, whereby the weakening interest rate level, as well as the stronger economic growth, played a role in this development. In 1999, however, the difference of 2.4 percentage points was still considerable.

The outlook for 2000/2001 leads to expectations that the picture from the nineties has only slightly changed in these two years as, in spite of a sinking interest rate and favourable growth, the gap is still wide, even though the difference should decrease.

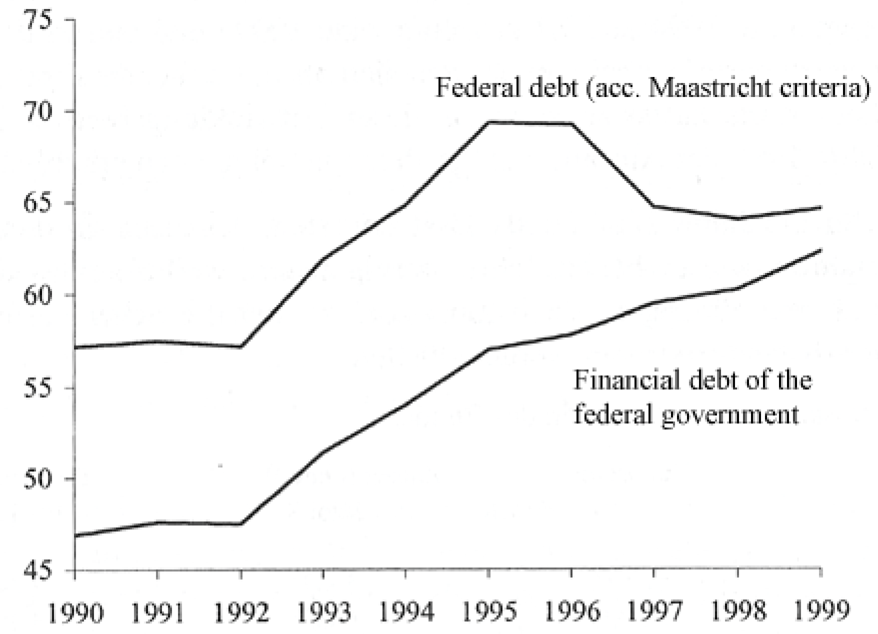
Overview 1: Net balance and primary balance of the federal government (in ATS millions)

	Net balance	Interest (without swaps)	Primary balance
1990	- 62.876	59.431	- 3.445
1991	- 62.703	66.686	+ 3.983
1992	- 66.397	72.254	+ 5.857
1993	- 98.240	75.714	- 22.526
1994	- 104.818	76.052	- 28.766
1995	- 117.903	84.777	- 33.126
1996	- 89.366	86.178	- 3.188
1997	- 67.219	88.146	+ 20.927
1998	- 66.027	93.267	+ 27.240
1999	- 68.194	98.912	+ 30.717

Source: Final budget accounts of the federal government; WIFO.

The primary budget showed a small surplus in 1991/92 (overview 1). This was, however, not sufficient to stabilize the federal debt ratio. It increased from 46.6% (1990) to 47.3% (1992). After 1993, the primary budget deteriorated considerably. In 1995, it showed a loss of 33.1 billion Austrian schillings. At that time, the Government Debt Committee already drew attention, in its recommendations, to the necessity of a budget consolidation seeing that, in these years, the increase in the debt ratio was being propelled by both components. It increased from 47.3% (1992) to 56.9% in 1995. The worsening of the debt ratio was caused by both the increasing primary losses and through the growing gap between the average interest rate and the nominal gross domestic product.

Figure 2: Outstanding public debt quota



Source: Government Debt Reports 1990/1999; Statistik Austria.

Starting in 1996, the federal government initiated a consolidation phase and the primary budget balance improved rapidly. As early as in 1997, a primary surplus of 10.9 billion schillings was attained. However, these improvements were insufficient to stabilize the federal financial debt ratio, seeing that the difference between the average interest rate and the nominal gross domestic product was (still) a decisive factor. In 1998/99, the primary surplus was also not sufficient to prevent the federal debt ratio from further increasing. It rose from 59.3% of GDP in 1997 to 62.9% in 1999.

This development leads to two possible conclusions. Firstly, under the given relationship between interest rates and the gross domestic product, the primary surplus should have increased even more than was the case. A surplus of 38 billion schillings would have been necessary in 1999 to stabilize the federal quota (it was actually 30.7 billion schillings). This shows that the increase in the debt quota was principally a result of the fiscal policy.

Secondly, the pressure on debt management increases when the primary surplus is insufficient. This is an important aspect of, and a justification for, the Government Debt Committee increasingly making recommendations concerning budget policies.

Consideration of the budget (particularly under the European Stability and Growth Pact) relates to the public sector as a whole. Therefore, it is consistent that, in recent recommendations, the Government Debt Committee has increasingly drawn attention to the relationship between the regional administrative authorities, particularly since the Austrian Federal Finance Agency now has the possibility of also conducting debt management for the provinces.

Of course, it is difficult to determine whether the recommendations of the Government Debt Committee affected the federal budget policies during the nineties. In any case, the Government Debt Committee supported the budgetary goals of the government in 1995/1997, as well as in recent times.

3 Recommendations on the Distribution of Ownership

A major portion of the recommendations of the Government Debt Committee is concerned with the structure of the distribution of ownership. The primary aspect dealt with, is how the necessary amounts (borrowing) are distributed between the individual creditor groups for the financing of the budget, whereby the composition between debts in schillings and foreign currencies, stands in the foreground. Three different aspects can be observed.

Firstly, the question (the problem) of crowding-out,

secondly, the aspect of cost (which debt shows lower interest rates) and

thirdly, the connection (influence) of the debt to the balance of payments and currency reserves, whereby this aspect decreased in importance as a result of Austria's participation in the Economic and Monetary Union and the introduction of the euro.

At the end of the sixties, crowding-out already played an important role in the discussions on the public debt in Austria. At that time, it was feared that the capital market was not in the position (given the circumstances of the period) of being able to finance a high budget deficit and that, at the least, rapidly increasing interest rates would have to be reckoned with in the country. Private demand would be suppressed and, through this, the positive, expansive effects of the fiscal policy could be greatly weakened or even countervailed.

At that time, borrowing in foreign currency was instituted primarily from an economic viewpoint. However, it was not possible to establish empirical proof of a crowding-out effect in Austria (Handler 1981). It, therefore, did play a major role in the recommendations made in the seventies and eighties. In the recommendations made in the early nineties this crowding-out effect is occasionally mentioned and recommendations for an increased indebtedness in foreign currency derived from this. In any case, the crowding-out phenomenon could also be combated through taking on schilling debts (in the form of marketable debts) from foreign investors. Similar indications can also be found in the recommendations made by the Government Debt Committee in the nineties.

In its recommendations dating from the early 1990s (1990,1994)[2], the Government Debt Committee drew particular attention to the crowding-out aspect and, therefore, recommended increasing the foreign currency component in order to protect the domestic capital market, and to prevent an increase in domestic interest rates.

The foreign currency share of the total federal debt was comparatively small at the beginning of the nineties (1990: 15.7%). It increased continuously in the first half of the 1990s to more than 21% (1994). This makes it clear that, during this period, the suggestions made by the Government Debt Committee were acted on.

However, the interest rates for debts in foreign currency were also considerably lower (on average) than those for schilling debts. This shows that the crowding-out argument, as well as the cost argument, increased during that time (as opposed to the seventies). At that time, the interest rates for foreign-currency debts were higher, on average, than for schilling debts.

Overview 2: Average nominal interest rates for the outstanding federal debt.

In %

	Schilling debt	Foreign Currency debt	Total
1990	8	7	8
1991	8	7	8
1992	8	7	8
1993	7	6	7
1994	7	5	7
1995	7	5	7
1996	7	5	6
1997	6	5	6
1998	6	5	6
	Euro debt		
1998	6	4	6
1999	6	4	5

Source: Government Debt Reports 1990/1999.

The difference in the rates of interest between foreign-currency debts and schilling debts lay by almost 2 percentage points in the mid-1990s (overview 2). This has decreased somewhat over the past years, but the difference in the years 1996/97 still amounted to more than 1%. After 1998, a (direct) comparison with the previous years is no longer possible, due to the introduction of the Euro.

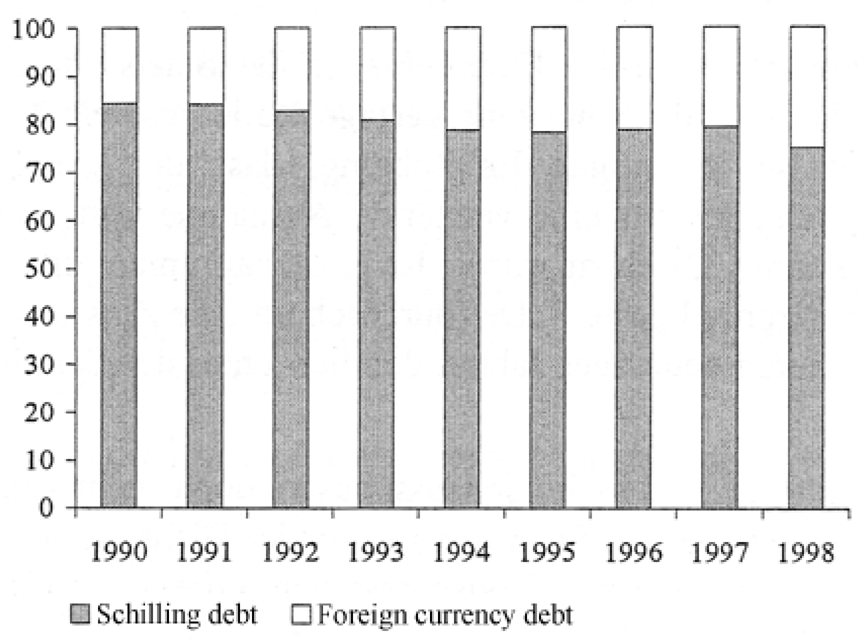
Cost arguments, however, played only a minor role in the recommendations made by the Government Debt Committee in the nineties. There are only minor indications, in a few recommendations, that the lower interest rates for foreign-currency debts would speak in favour of taking out foreign-currency loans. It is apparent that the cost argument was not placed in the foreground of the recommendations. The average interest rate for the debt lay considerably beneath the schilling debt during the entire 1990s (overview 2).

However, in its recommendations on foreign-currency debts, the Government Debt Committee drew increasing attention to the connections between the balance of payments and foreign-exchange reserves. Apparently, the taking out of foreign-currency loans was also intended to compensate for the flow of foreign exchange, resulting from the deficit in the balance of payments, through borrowing in foreign currency, thus supporting the hard-currency policy. In this way, the Government Debt Committee pointed out, as early as in its recommendation made in 1990, that borrowing in foreign currency should only be carried out up to the amount of the due debt-service payments. Similar recommendations were also made in 1992, 1993 and 1995. This aspect, however, became weaker with the introduction of the euro.

Basically, the recommendations made concerning foreign-currency borrowing are usually rather reserved. This can be clearly seen in the recommendation made in 1999 in which the Government Debt Committee advises that the foreign-currency component not be reduced but that restrictive limits be observed. It must be taken into consideration that, since the introduction of the euro, the foreign-currency share has (formally) been greatly reduced.

Fig. 3: Schilling debt and foreign-currency debt of the federal government

Share of the federal debt in %



Source: Government Debt Report 1999.

For the longer term, during the nineties (until 1998), the share of foreign-currency borrowing in the total federal debt was noticeable (rising from merely 16% at the beginning of the nineties to more than 20% in the second half of the decade) (fig. 3). It seems likely that the cost argument did, indeed, play an important role.

The Government Debt Committee is cautious in the tendency of its recommendations on the distribution of ownership, and has often drawn attention to specific limits. This can be clearly seen, for example, where it advises to only take on foreign-currency debts to the amount of the debt-service in foreign-currency loans (1990, 1993, 1995). Of course, it could be argued that the savings arising from the lower interest rates for foreign-currency borrowing were substantial. With an unchanged share in the financial debt, as in 1990, it would have led to a 142.4 billion schilling lower foreign-currency debt. But, using the same differences in interest, the amount of interest in 1998 would have been 2 billion schillings higher if the portion of foreign-currency debt in the total federal debt in 1990 had remained the same in 1998.

4 The Term-Structure of the Debt

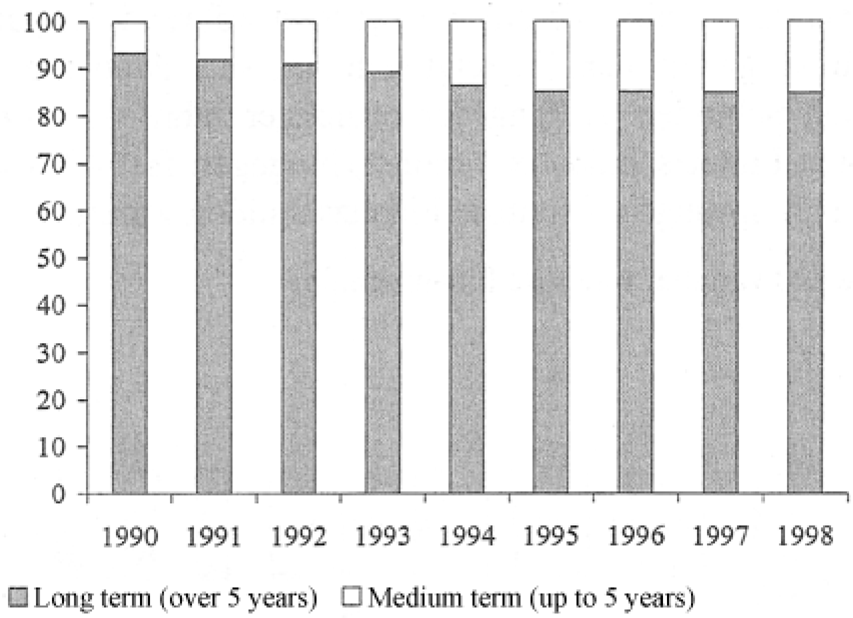
In the recommendations, much space is given to statements on the term of the debt. Initially, the recommendations were aimed more at the long-term financing of budget deficits. This can be justified using the “pay as you use” argument, firmly anchored in the theory of public finance and particularly stressed by Musgrave (Musgrave 1969).

If it is assumed that investments in the infrastructure will have a lengthy lifespan and that they will also benefit following generations, this would make it justifiable to opt for long-term financing, under which the future generation would bear its part of the costs. For a long time, this theory had a great influence when dealing with the term of public borrowing. The relationship between investments and financing has diminished in the public sector over the past years, but the German constitution (article 115) and the Maastricht treaty, also contain (rudimentary) formulations in this direction.

In addition to this argument, debt management also plays an important role when dealing with the term-structure of borrowing. The recommendations made in connection with terms changed several times during the 1990s. In 1991 and 1992, the Committee recommended favouring long-term borrowing whereby the amortization structure should be taken into consideration. In fact, the portion of long-term debt (over five years) in the total federal debt was above 90% at the beginning of the nineties (figure 4). In those days, the share of long-term debt was held at a high level, in accordance with the concepts of the Government Debt Committee.

Figure 4: Term of the federal financial debt

Share in %



Source: Government Debt Report 1998

This picture changed in the mid-nineties. The Government Debt Committee recommended including money-market securities within the framework of borrowing in order to build up a relevant segment. The government debt, particularly the schilling debt, has shown a definite move towards medium-term spans. The share of medium-term debt rose from 6.7% in 1990 to 15.2% in 1998 (figure 4).

The decrease in the time span is reflected in a lower (average) remaining period of the debt. It increases the flexibility of debt management which, particularly in view of the rapid changes in the determining conditions on the markets, is extremely important.

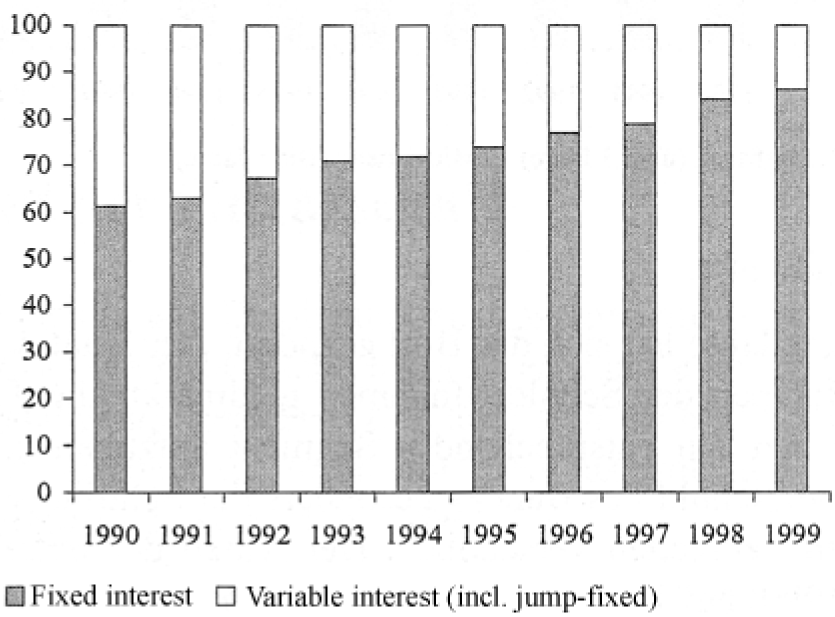
This decrease permits a speedier reaction to changes in market conditions. This applies particularly to the introduction of (or change to) the euro. In addition, shorter periods also diminish the present-value risks. In spite of the increase in the share of medium-term debt in the total federal debt, Austria still lies below the EU average. The average term for financial debt is (in most cases) considerably shorter in the other countries.

5 Fixed versus Variable Interest

The development in the interest level has also led to a restructuring between fixed and variable interest financing. The Government Debt Committee rarely took a position on this question (fixed versus variable interest) during the entire period of the nineties. An extremely pronounced shift towards debts with fixed interest can be observed. At the beginning of the 1990s, somewhat more than 60% of the total debt had fixed interest rates whereas 40% was variable. However, 11% of these were debts with a “jump-fix” interest rate (fixed costs adjusted periodically).

Figure 5: Debts with fixed and variable interest rates

Portion in %



Source: Government Debt Reports 1990/1999.

In the first half of the nineties, the share of debts with a fixed interest rate rose from 61.3% in 1990 to 73.8% in 1995, whereas those debts with variable interest rates sank respectively (figure 5). This tendency continued in the second half of the decade. By 1999, 86% of the total federal debt had fixed interest rates. In this way, debt management had attempted to take advantage of the low interest level and to borrow at a fixed interest rate.

6 Lower Average Rate of Interest

The result of debt management can be gauged by the average interest rate of the financial debt, whereby a comparison with other EU countries is useful.

Overview 3: Average rate of interest of the public debt in an international comparison

Interest amount in % of the average level of debt in the period under observation

	1995	1997	1999
Belgium	7	6	6
Germany	7	6	6
Finland	9	8	8
France	8	7	6
Ireland	6	7	5
Italy	9	8	6
Luxembourg	5	6	6
Netherlands	8	7	7
Austria	7	6	6
Portugal	10	7	6
Spain	9	7	6
EU average	8	7	6

Source: Government Debt Report 1999.

Since 1995, Austria has been able to reduce the average interest rate for its public debts from 6.6% to 5.7%. The average rate of interest in Austria is the lowest of all states in the European Economic and Monetary Union – with the exception of Ireland. In comparison, the average interest rates in both Germany and France (5.8%) are at approximately the same level. The levels in the Netherlands (7.0%) and Finland (7.6%) are considerably higher. The average interest rate in the euro area was 6.0% in 1999.

Summary

The influence (importance) of the recommendations made by the Government Debt Committee can be evaluated under two different aspects – on the one hand, from the viewpoint of fiscal policy and, on the other, of debt management. In connection with fiscal policy, the Government Debt Committee often insistently urged the government to reduce the budget deficit during the nineties.

The government attempted to reduce the deficit. However, one must bear in mind that not only the Government Debt Committee was responsible for the move to consolidate. The target for the participation in the Economic and Monetary Union, which stipulated that the deficit in 1997 be reduced to a maximum of 3% of GDP, was also very important. According to the latest information we have, the deficit in 1997 was 1.8%. It is, however, difficult to evaluate how greatly the recommendations of the Government Debt Committee have actually influenced the fiscal policy of the government, seeing that the budget consolidation was also encouraged for other reasons.

When considering those recommendations made in connection with debt management, it can be recognized that a considerable number of the proposals made were implemented. The Government Debt Committee has therefore fulfilled its important task to a great extent. The results can be seen as extremely positive if the average rate of interest for the federal debt is used as a measure and indicator, and a comparison made the with other countries of the euro area. All this has taken place under the chairmanship of Professor Frisch.

Notes:

1. The National Debt Committee generally presents its recommendations twice a year (usually in June/July and November/December).
2. The numbers in the brackets refer to the years in the titles of the individual publications (e.g., report of the Austrian Postal savings Bank on the Government Debt, 1990). The printed recommendations are in connection with the following year, e.g., 1991. This temporal difference of one year is valid for all reports from the 1990s.

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