Recommendation of the Government Debt Committee on Budget Policy and Financing 2009

Resolved in the meeting of the working committee on November 25, 2008, and approved in the meeting of the Government Debt Committee on December 3, 2008.

The world economy has clearly lost momentum in 2008 at 3.7% growth (IMF) (2007: +5.0%). The collapse of real-estate markets in the U.S. and several European countries, the sharp increase in raw material and food prices until mid-2008, and in particular escalating financial market distortions in the second half of 2008, resulted in a dramatic economic downturn in industrialized countries. It is assumed that a further economic slowdown will be witnessed in 2009: Whereas relatively brisk economic momentum is expected for China and India, the highly developed economic areas, such as the U.S., Japan, the U.K., and several euro-area countries will find themselves confronted with a recession in 2009.

Admittedly, internationally agreed measures (central banks providing liquidity, governments assuming full liability for inter-bank transactions and savings deposits, bank recapitalizations) have been taken to reestablish trust among market participants. Nevertheless on account of the uncertainty about the duration and the extent of the financial crisis downside risks still prevail.

In 2008, economic growth of approximately 1% in the euro-area (European Commission, OECD) turned out to be extremely weak. For the first time since the introduction of the monetary union a shrinking GDP (on the previous quarter) was recorded in the second and third quarters of 2008. The reluctance of consumers to spend and the slowing of investment activity as a result of the problematic conditions faced by financial markets, the marked loss of investor trust, as well as the global downturn were the main reasons for this development. The present framework and also the plummeting confidence indicators of the European Commission signal a further flattening of economic development in the euro-area. In addition, a slight recession in 2009 (on an annual basis) cannot be ruled out.

The Austrian economy has developed relatively favorably in 2008 with growth of just under 2% on a year-to-year basis (2007: +3.1%), but it clearly lost impetus in the course of 2008. Foreign trade growth, in particular demand from Central and East European countries, once again was a mainstay of the domestic economy in 2008. In spite of economic stimulus packages, global economic slowing and pessimistic expectations (enterprises showing less propensity to invest and private households holding back on spending) give rise to expectations that the Austrian economy may also stagnate in 2009. At present a credit crunch is not being forecast, but the credit conditions for enterprises have worsened significantly on the backdrop of financial market turbulence. On the labor market the increase in employment figures, which was high in 2008, will continue, but will be curbed in 2009, and unemployment figures will rise again for the first time since 2005.

In spite of a positive development of tax revenues, the deficit of the general government will be higher than in the previous year (Budgetary Notification of September 2008: -0.7% of GDP; 2007: -0.4% of GDP). In 2008 revenues within the budgetary scope of the federal government and provinces are likely to flow into economic stimulus packages carried out by individual provinces as well as into debt relief programs and measures to strengthen consumer spending (including lowering unemployment insurance contributions, increasing the commuter allowance, increasing pension adjustments ahead of schedule, granting an extra monthly family allowance payment, granting heating-cost benefits). Through the new revenue-sharing regulations, 2008 the provinces and the municipalities have increased revenues in the amount of net EUR 235 million at their disposal.

A marked increase in the budget deficit of the general government to significantly more than 2% of GDP is expected for 2009. This deficit increase is a result of automatic stabilizers as well as discretionary governmental measures to absorb the burden of inflation and to stimulate the economy. In this connection three federal government packages and budgetary measures of September 24, 2008, deserve special mention, whereby the most recent package (tax reform and a second economic stimulus package) is a government program agreement that has not been passed by Parliament.

- **Measures of September 2008 to absorb the burden of inflation:** increasing the pension adjustment of 2009, which was put ahead of schedule to November 2008 (+3.4% and one-off payments), extending the special retirement scheme for workers with above-average years of contributory service ("*Hacklerregelung*"), introducing an extra monthly family allowance payment, lowering the value-added tax on medication to 10%, increasing long-term care benefit by 4% to 6%, boosting support payments for the 24-hour-care package, extending tax exemption for overtime payments and overnight stays, granting heating-cost benefits for people with minimum pensions, abolishing tuition fees for college and university students, as well as suspending value adjustments on the motorway permit sticker for 2009.
- **Economic stimulus package of the end of October 2008**: increases in credit lines and liabilities for reduced-interest rate loans (billion-euro package (*"Mittelstandsmilliarde"*) for small and midsize businesses) pushing ahead infrastructure investments of the ÖBB (Austrian Railways) and ASFINAG (*planning, construction, maintenance and operation of motorways and expressways in Austria)**,*** increasing the bonus for saving plans with building and loan associations (*"Bausparprämie").*
- **Measures to stabilize financial markets**:
    - o Setting up an independent clearing bank (*Österreichische Clearingbank AG*) to provide liquidity among banks (government guarantees to an amount of EUR 75 billion).
    - o Taking measures to recapitalize banks (acceptance of liability, granting loans, acquiring company shares) to an amount of EUR 15 billion.

- Introducing unlimited deposit insurance (as of January 1, 2010, limited to an amount of EUR 100,000) for natural persons (subsidiary federal guarantee of EUR 10 billion).
- Extending competencies of the Financial Market Authority (“*FMA*”) (increase in equity requirements of banks under the aspect of risk, option to ban or limit short-selling transactions).

- **Government agreement of November 2008:** Tax reform (reducing wage and income tax 2009 and providing additional funds for families) amounting to a total of EUR 2.7 billion; economic stimulus package for 2009 and 2010 amounting to a total of EUR 1.9 billion (scheduling ahead construction projects of BIG, (“*Bundesimmobiliengesellschaft*”, the Federal Real Estate Corporation), (which will only partly affect the budget), introducing temporary investment incentives for companies, providing additional funds for research and development as well as for regional employment programs).

For 2009 and 2010 additional expenditures and a reduction of revenues as a result of the above-mentioned offensive economic programs are expected to be in the scale of EUR 4 billion in total. This amount does not include budgetary effects resulting from the package of measures to stabilize financial markets, which from today’s perspective are not expected to be utilized in 2009.

On the basis of the economic and institutional framework previously mentioned, the Government Debt Committee recommends the following for 2009:

- Massive stabilizing measures of the government to mitigate the financial crisis and its subsequent effects on the real economy and at the same time to keep a close eye on fiscal sustainability. Budgetary scope is a prerequisite for government packages of measures. Only a credible, solid mid-term budget path that in no way casts doubt on the excellent creditworthiness of the Republic of Austria will allow such a scope for Austria’s budget policy.

- To let the cyclical decrease in revenues and increase in expenditures take their full effect and to promote discretionary temporary measures to stimulate growth (e.g. moving ahead infrastructure investments, increasing the use of human capital, lowering the tax burden on the labor factor, introducing credit lines for investments), which will subsequently enable the widening deficit to be curbed. Keeping the deficit from widening will only be possible if growth rates in the scale of the potential growth rate (around 2% or more) are reached at the end of the new legislative period and the structural reforms described in the following paragraphs are put into practice.

- Given the difficult economic situation, to put the appropriate essential structural reforms into effect immediately (including health care, social matters, school education, grants, employee and pension laws, standards that drive up expenditures, tax structures) in order to maintain the present mid-term budget goal of a balanced budget throughout the economic cycle.

- To adjust the goals of the Austrian Stability Pact (ASP) 2008 in light of an altered economic framework and to implement a more effective controlling program. The results of the Budgetary Notification of March on the budget transactions of the government and its subsectors in the past years should already be utilized in order to set obligatory correctional processes in motion as required in conjunction with the existing coordinating committees of the ASP (provincial committees, federal coordinating committees). Also reports that outline the budgetary policy in the context of the general government direction of the subunits and take into account the political responsibility of the units have not been made accessible to the public. In addition an evaluation for the ASP 2005 (2005 – 2007) of the completed stability contributions of individual public authorities and the administrative bodies as a whole have not yet been made available for the years 2006 and 2007.

- To specify more precisely the substance and the temporal framework of the goals that were agreed in the course of the new revenue-sharing regulation of 2008 in the area of administration reform (harmonizing pension systems, reducing the number of civil servants). In this connection it should be pointed out once again that sound data on the level of government civil servants (including spun-off government-related units according to ESA 95) have still not been submitted.

- To press ahead the reform triangle of a federal and financial constitutional reform as well as an administrative reform involving all levels of government in a synchronized way and on the highest political level in order to ensure an adjustment of intergovernmental issues (including health care, social matters, school education, tax law) in this legislative period. Viewing the allocation of competencies separately without any structural or content-related alignment to the constitution or revenue-sharing regulations is imperfect and the allocation of financial burdens is inseparably linked to that of the responsibility for a particular duty.

- To create the statistical basis for an outcome-orientated management of budgets of the individual administrative bodies, whose introduction on the federal level is planned as of 2013, and to introduce the required processes. Performance budgeting requires comprehensive information according to area of responsibility (including costs, benefits, and outcome) independent of institutional settings. This also means that among other things, additional information on spun-off-government–related units on all levels, prompt and more conclusive information on budget transactions and personnel requirements of provinces and municipalities as well as harmonized accounting standards compatible with commercial accounting will be required.

- To direct more attention to the government’s asset and liability management in light of the difficult market environment and to reconsider the risk strategy in view of new findings. In the course of the financial crisis, weaknesses (underestimating the counterpart- as well as market-price risks) in the area of risk management of public entities became obvious. Therefore it is recommended that guidelines are to be prepared and obtaining independent information on financial matters is to be made obligatory. From the point of view of the government debt committee a low-risk strategy is to be given preference.