



## **Recommendation of the Government Debt Committee on Budget Policy and Financing 2010**

Resolved in the meeting of the working committee on November 25, 2009, and approved in the meeting of the Government Debt Committee on December 2, 2009.

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After the deep worldwide recession, the global economy rebounded sooner than expected in the second half of 2009, due to the fact that extensive intervention of central banks and the public sector reduce insecurity on financial markets and curb demand shortfall. The IMF revised its forecasts slightly upward for 2009 and 2010, but is still assuming that the global economy will shrink by 1.1% of GDP in real terms in 2009 on a yearly basis. In 2010 even though the global economy is expected to expand once again, the projected growth rate of 3.1% (IMF), will even then remain significantly below the values of the years before the crisis.

In the euro-area, signs that the economy has been stabilizing (continual increase in the economic sentiment indicators of the European Commission and the ifo indexes) have also been rising since the second half of 2009, even though economic performance is expected to contract by 4.0% (OECD) for the year as a whole. EU exports as well as domestic demand are likely to consolidate only gradually. Several factors, such as stiffer financing conditions, lower capacity utilization, unfavorable perspectives on the labor market, are further lowering demand, so that only moderate GDP growth is being forecast for the euro-area in 2010 (e.g. current OECD forecast for 2010: +0.9% on the previous year).

In 2009 economic performance in Austria will contract by around 3.5% in real terms on the previous year. In particular, the fall in exports as a result of a global lack of demand was responsible for this massive downturn. Additionally, enterprises were confronted with stiffer financing conditions (stricter standards for loans and more cautious creditworthiness assessments by banks) so that in 2009 not only the external balance but also investments will show a strong downward development. Aggregate demand benefitted from tax reform, economic stimulus packages, the increase in transfer payments and high public consumption. Private consumption will prove to be a robust component of demand with slightly increasing real growth rates in 2009 and 2010. Private consumption was positively affected by tax reductions, a fall in inflation, as well as above-average high wage gains in 2009. The recession is assumed to have reached its peak in the first quarter of 2009 at -2.7% on the previous quarter. Positive growth rates (on the previous quarter) are expected in the second half of the year due to the recovery of the global economy. In 2010 economic policy will continue to be a driving force, as the endogenous buoyancy of Austria's economy – as well as that of Europe – will be too weak for a self-supporting recovery. Real GDP in 2010 is likely to grow only in the range of 1% on the previous year - according to forecasts of Austrian research institutes from September 2009.

In 2009 recession was already leading to a significant worsening of conditions on the labor market: The average number of actively employed workers decreased from January until October 2009 by more than 45,000 persons on the previous year. The average number of unemployed rose in the same time period by about 50,000 persons on the previous year, although extensive labor-market measures (short-time work, expansion of training course offerings of the Austrian Employment Center (AMS)) were taken to counteract this rise in unemployment. For 2009 the unemployment rate (Eurostat definition) is expected to increase considerably to over 5% (2008: 3.8%). In light of the muted growth prospects for 2010, a further aggravation of the situation on the labor market will likely take place.

In 2009 consumer prices are rising only slightly, as the international recession and basis effects (induced by the rise in prices of mineral oil and raw materials in the previous year) are having a strong curbing effect on price development. The inflation rate is expected to be somewhat higher in 2010.

The consequences of the global financial and economic crisis are very clearly reflected in the development of the public fiscal position: the public deficit for 2009 will be almost 4% of GDP following a public deficit of 0.4 % of GDP in 2008. In 2010 the public deficit is expected to further increase to around 5% of GDP. In addition to the effects of the automatic stabilizers (lower tax revenues, increasing restraints due to high unemployment), discretionary measures (economic stimulus packages, tax reform, extended benefits compared to the previous year in the areas of long-term care, pensions and for families), are putting a great deal of strain on public budgets. Additionally, for the end of 2009 a public debt-to-GDP ratio of 68% of GDP is expected and in 2010 this tendency is forecast to increase. The European Commission assessed the violation of the deficit limit of 3% of GDP to be neither temporary nor insignificant and at the end of October 2009 introduced proceedings against Austria as well on grounds of an excessive public deficit.

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

- To the extent that economy develops as projected – to put the resolved measures for 2010 into effect in a timely manner and not to set any budgetary measures that could have a negative effect on cyclical recovery.
- To lose no time in preparing extensive structural reforms to curb debt growth and to avoid excessive deficits of the general government in Austria. The goal is to achieve a smooth transition from the phase-out of support measures (stimulation of the economy, financial market stability) to consolidation measures with a middle- to long-term time perspective. An exit from the crisis should combine action to secure financial market stability with measures to increase potential growth and to guarantee fiscal sustainability. High public debt-to-GDP ratios that show a tendency to increase do not only put pressure on the market interest rate level (risk surcharge) but also in particular, place great limitations on fiscal leeway. If the correct point of time for ending

the stimulatory and stabilization measures of the government is not chosen, stabilization effects may fall short, while at the same time the requirement for public consolidation increases. For Austria's financial policy this also means that coordination of budgets within Austria must be intensified in the framework of the existing institutions.

- To achieve a breakthrough in the institutional and competence reform of public responsibilities on all levels of government (“who does what and with which instruments”) through a strong joint effort. The goal is to master a sustainable middle-term return of the budget deficit to about 1% of GDP and in doing so to assure that the negative effect on Austria's economic growth remains as minor as possible. Substantial long-term efficiency gains that bring cost-cutting and necessary budgetary shifting towards growth-promoting expenditures are required and can only be achieved if existing weaknesses can be eliminated (overlapping of competences, co-financing, lack of goal-orientation, input considerations instead of outcome orientation) in the framework of an administrative, federal and revenue-sharing reform. Only if responsibilities (responsibilities for functions, expenditures and revenues) and strategies are clear-cut, will there be incentives for an economical and effective use of public funds. The present revenue-sharing scheme hardly provides any incentives for public bodies to be cost efficient or to refrain from exhausting all available funds and through (certain) earmarking, reduces the scope of provinces and municipalities to manage expenditures. The present federal budget reform should be implemented promptly and all other levels of government are called upon to follow suit with this reform.
- To intensify the administrative reform process now in progress significantly by serious cooperation of the highest-ranking policymakers and to accelerate this reform by means of a set schedule. Of the eleven work packages (administrative efficiency, education administration, service law, pension rights of civil servants, health and long-term care, grants, environment and infrastructure, science and research, deregulation, responsibility reform, revenue sharing) included in the administrative reform project completed results of experts (court of auditors (RH), Institute of Economic Research (WIFO), Institute for Advanced Studies (IHS), Government Debt Committee (StA,) Centre for Public Administration (KDZ)) in the areas of administrative efficiency, education administration, pension rights of civil servants, and grants have been presented. However, there has still been little consensus on these recommendations on the political level. The urgency of these structural reforms is increasing dramatically due to the rise in public debt. A return of the debt-to-GDP ratio to 60% of GDP requires sound public finances with budget deficits around zero in the course of several years. A decisive improvement of public finances based on high increases in revenues on all levels of government as a result of a robust economic development is not expected for the upcoming years.
- To determine consolidation strategies for the federal government, provinces, and municipalities and to provide these strategies with a legal basis by aligning them with the standards of the Austrian Stability Pact 2008. The required scope of consolidation that will be necessary for many years will call for great effort on all levels of government and indicates the need for a joint approach of all public bodies. In order to guarantee that these measures are implemented, the



effectiveness of existing coordination committees of the Austrian Stability Pact (provincial committee, federal coordination committee) needs to be enhanced and coordination talks and public reporting obligations need to be scheduled. Federal matters and their implementation do not run counter to a stronger orientation of the general government. This coordination has the goal of increasing the effectiveness and the target-orientation of various measures.

- As a first step, to regain budgetary scope by means of structural measures in connection with expenditures and to limit tax rises to the lowest necessary extent and in doing so to minimize negative effects on aggregate demand and competitiveness.
- To strengthen risk identification, directing, and control on all levels of government in public risk management and to give preference to a low-risk middle-term funding strategy as well as a low-risk investment strategy on all levels of government. In this connection it is both appropriate and efficient that the planned legal amendments concerning the liquidity of the federal government (cash-raising operations, “Kassenstärker”) (No 480 of the supplements to the minutes of the National Assembly XXIV Legislative Period) in the course of the second stage of the budgetary law reform originally set for 2013 should be pushed ahead to 2010.
- To observe and implement the recently completed guidelines and recommendations of the working groups “financial management of the federal government.” These guidelines provide mainly for the following:
  - Strict separation of the treasury function and the risk-management function on all structural and procedural levels with clearly defined guidelines for orders and control between the federal government and the Austrian Federal Financing Agency as well as in the Federal Ministry of Finance itself;
  - Limits for all risk factors and their corresponding processes in consideration of ethical standards and the reputation risk in the risk assessment;
  - Extensive, gradual reduction of the open positions in foreign currency risk;
  - Continued development of the present creditworthiness assessment system;
  - Not taking avoidable risks, especially not those having the goal of attaining additional earnings;
  - Improving the synergy potential of the general government in the area of financial management.