



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

Resolved in the meeting of the working committee on June 23, 2010, and approved in the meeting of the
Government Debt Committee on June 30, 2010

Extensive monetary and fiscal policy measures mitigated the consequences of the pronounced recession in 2009 on a worldwide basis and contributed to an unexpectedly speedy recovery of the world economy, which began as early as the second half of 2009. For 2010 the IMF is expecting real growth in the global economy of 4.2% and for 2011 4.3% on a yearly basis (2009: -0.6%). Although the confidence indicators (Economic Sentiment Indicator of the European Commission and the ifo indexes) in the euro area have been showing a strong growth tendency since mid-2009, the European Commission is assuming that real growth for 2010 will be only approximately 0.9% on a yearly basis (2009: -4.1%). This development is due to weak domestic demand: in 2010 gross capital formation decreased once again on the previous year and private consumption was limited as a result of weak growth in incomes and lower employment figures. From today's point of view, an acceleration of economic growth is expected in the euro area (European Commission: +1.5%; OECD: +1.8%). However, there are downward risks (recent financial market tensions, stronger negative effects of the reversal of fiscal and monetary stimulatory measures as well as rising costs of raw materials) that potentially could interrupt economic recovery.

As a result of the global recovery in 2010, strong growth of export demand is expected that will support the predicted recovery - a real increase of GDP of about 1.5% on the previous year (2009: -3.5%). Domestic demand, on the other hand, shows only sluggish growth. The decisive factor is weak investment development, which is determined by the present overcapacity, and a change in the trend to positive economic growth is not expected to come about until the second half of 2010. Private consumption has once again proven itself to be a strong demand component with a forecasted real growth rate of about 1% in 2010. For 2011 economic growth recovery is likely to be in the range of 1.5% to 2%. Thus GDP growth for 2011 is expected to remain lower than the yearlong average.

The recession was clearly noticeable on the Austrian labor market in 2009, even though measures of active labor market policy (e.g. short-time work models) mitigated the consequences of the recession. The situation on the labor market will also remain gloomy in 2010 and 2011. The negative effects of the recession on the labor market are likely to be relatively low by international comparison. For 2010 average growth of the number of actively employed workers of about 16,000 persons (2009: -44,800 persons) as well as an increase in the average number of unemployed in the range of 3,000 persons compared to the year before (2009: +48,100 persons) is expected. At the end of May 2010 the number of actively employed workers increased by 26,000 persons on a yearly basis. The number of unemployed decreased in the same period by slightly less than 13,000 persons. On the whole, economic growth is too weak to bring about a lower unemployment rate in the coming years (Eurostat-definition: 2010 about 5.0%; 2009: 4.8%).



In 2010 the budget deficit of the general government, which was already on the high level of 3.4% of GDP in 2009, will increase drastically (-4.7% of GDP according to the Austrian Stability Program of January 2010). In addition to the effects of the automatic stabilizers (decrease in tax revenues, increasing burden on account of the high employment rate), discretionary measures (tax reform, economic recovery packages, increase in benefits of previous years in the areas of long-term care, pensions, and for families) are putting an ongoing great strain on public budgets. In addition, the decrease of the GDP level in the crisis year 2009 caused the tax base to diminish strongly. Starting with 2011 according to the recent stability program and strategy report on the Federal Budgetary Framework Law 2011-2014, a consolidation phase is expected to begin that will secure a return to a negative budget deficit of below the reference value of 3% of GDP by the year 2013 in keeping with the recommendations of the European Council. The debt ratios of all levels of government will reach about 70% of GDP – with a tendency to further increase in the following years – (2009: 66.4% of GDP). The presently planned consolidation path is not sufficient for a reduction of the debt-to-GDP ratio.

The global financial and economic crisis led to a revaluation of economic strength and long-term sustainability of public debt (creditworthiness) of individual states, which was accompanied by increased risk premiums and also in individual cases by financing constraints. For this reason in May 2010 a “financial stabilization mechanism” for the euro area was implemented in addition to an aid package for Greece (bilateral loans granted by member states of the euro area and the IMF of up to EUR 110 billion within three years). This includes financial support for EU member states that are having unusual economic or financial problems. In the framework of these support measures, which are granted under strict consolidation conditions, a total of EUR 750 billion for lending by the European Commission, the IMF, and a special purpose vehicle for loans is available for euro countries. Austria is taking part in these programs with a maximum lending volume of EUR 2.3 billion to Greece as well as assuming guarantees in the amount of EUR 15 billion under the stabilization mechanism.

The Debt Committee confirms the recommendations of fall 2009 and in light of the afore-mentioned framework makes the following additional recommendations:

- To make use of the expected slight economic leeway starting with 2011 and to introduce a consolidation course that is substantiated by developing specific measures as soon as possible. Fiscal policy must not provide a starting point for speculations. At present a revaluation of public debt is taking place by investors and the creditworthiness of Austria must not be called into question. In any case, a mid-term consolidation strategy should be credibly communicated in 2010. While by means of the Federal Budgetary Framework Law 2011 to 2014 and the strategy report, the consolidation framework has been created for the federal government; the consolidation contributions of the provinces and local governments that are also obligated to take effect in 2011 would still need to be drafted in a credible manner. Additionally, provincial and local governments should establish midterm-binding expenditure plans according to the model of the federal government. Consolidation measures of provincial and local governments should both



facilitate the necessary consolidation contribution and also take into consideration the goals of growth and employment. Sound public finances are necessary in order to support sustainable economic growth, to offer sufficient leeway in order to be able to react to possible future crises, to meet the challenge of demographic changes, and not to burden future generations with excessive debt.

- To achieve consolidation mainly by sustainably lowering spending dynamics. In the midterm, budgetary leeway is to be regained by means of structural measures on spending and by limiting increases in revenue to the necessary extent whereby at the same time negative effects on macroeconomic demand, allocation, and competitiveness are to be kept at a minimum. According to the Strategy Report 2011 to 2014 of the federal government 60% of the consolidation requirements should be covered by means of spending measures and 40% by revenue measures. There should be consistent implementation of this ratio.
- To renegotiate the Austrian Stability Pact. The legally binding agreement of the Austrian Stability Pact 2008 is outdated against the background of the economic crisis and without specifying the scope of consolidation in more exact terms. In order to guarantee that these measures are implemented, the effectiveness of the existing coordination committees of the Austrian Stability Pact 2008 (Federal Coordination Committee, provincial committees) would need to be enhanced and coordination meetings and reporting obligations established. Federal matters and their implementation are not in contradiction with an intensified general-government orientation. Coordinating economic measures in Austria can increase goal orientation and effectiveness.
- To support an exit from the crisis by means of a sustainable consolidation policy of public budgets that reinforce growth. Such a consolidation strategy geared to improving the quality of public finances must increase the efficiency and effectiveness of the way that public bodies perform their duties by means of a critical review of obligations, clear setting of priorities, process optimization, and structural measures and should constitute a common effort to be borne and implemented by all levels of government. In particular, education (including child care measures), infrastructure investments (priority of rail over road), as well as research and development are considered to be public responsibilities that promote growth, whereby however, an economical use of funds is advisable and increases in efficiency through restructuring should be an aim. Such public investments (in the broad sense) can have a widespread positive effect on productivity and economic growth as well as on employment, quality of life, and attractiveness as a business location. However, a self-financing rate of 100% or more for infrastructure investments can only ensue by means of very long-term cost-benefit considerations and even then not for all projects.

- To remedy the reform backlog in the sector of public administrations (optimizing internal as well as overlapping processes and structures) through rapid fundamental political decisions and in the following to strive to implement the numerous existing reform proposals by the end of 2010. As a result of the lack of political consensus on the reform proposals that have already been prepared by experts (RH [Court of Auditors], WIFO [Austrian Institute of Economic Research], IHS [Institute for Advanced Studies], StA [Government Debt Committee], KDZ [Centre for Public Administration Research]) among other things in the area of administrative efficiency, education, civil servant pension law, subsidies, and health care, the pressure to consolidate is being transferred to those sectors that contribute to sustainable growth. The concentration on large areas of responsibility, such as health care, education, grants, local transport, etc. lends itself for treating these areas as a single package in the decision-making process. Unless there is a mutual effort of political decision makers in Austria that accomplishes a breakthrough in the reorganization of institutional and the legal competence of the administrative bodies, the improvement in the quality of public finances can only remain rudimentary.
- To arrange for instruments in the legal norms of all levels of government that are designed to help to avoid politically motivated economic emphasis before elections (“election gimmicks”) to the extent possible. As there is a tendency in politics to attach too little importance to increased new debt, fiscal regulations in all public budgets and self-commitment of policy makers to these regulations are an opportunity to stem the inclination of governments to take on more debt.
- To utilize the time slot of the second phase of the present revenue-sharing period (2011 to 2013) to reorganize the revenue-sharing system and to introduce approaches to a fundamental reform of revenue sharing that is focused on key responsibilities and to take political decisions as soon as possible. In this context a reinforcement of self-responsibility by reducing the distinctive dependency on transfers and strengthening the tax autonomy of the sub-sectoral government levels should be a priority. Additionally this process should be carried out in coordination with the project Administrative Reform (above all, with the work package “reassignment of duties”) and consequential changes in the Federal Constitution and the Financial Constitution. The revenue sharing system should also provide incentives for cost efficiency. Due to (partial) earmarking, the present revenue sharing system additionally reduces the leeway of provinces and local authorities in dealing with expenditures.
- To provide for a thorough analysis of spun-off units on the part of the owners (goals of spin-offs, best-practice guidelines, control mechanisms, debt, guarantees, leasing, evaluation of goals and performance, transparency, etc.) as well as to develop a binding framework for a comprehensive registration of units previously owned by the public sector in Austria. The circumstance that at least half of the local authorities in Austria have infrastructure firms that are not integrated in their budgets presents a particular challenge on the local government level (including supervisory bodies of local authorities) with many small organizational units. In addition meaningful reports on spin-offs should be prepared on all levels of government.



- To implement compatible financial reporting standards and budget management standards for all levels of government (including units previously owned by the public sector). A consolidated registration within and among administrative units as well as obligatory management of equity interests has become more urgent in light of the macro-economic requirement for co-ordination and the growing number of units previously owned by the government that are not integrated in public budgets and have interlocking financial relationships with administrative bodies. Main features of such guidelines have already been included on the part of the federal government in the framework of the budget law reform that is taking place and is welcomed by the Debt Committee and is also being seen in a positive light internationally. As a result of the diverging control criteria and instruments in the spun-off services and services within the administration, the harmonization of public functions is no longer guaranteed.
- To follow the pathway chosen and to continue to strengthen risk management (risk identification, risk directing, and risk control) on all levels of government in order to guarantee a low-risk, midterm-directed funding strategy, as well as a risk-averse investment strategy on all levels of government. Additionally a clear-cut institutional separation of front and back office (treasury and risk management) must take place.