



## Recommendation of the Government Debt Committee on Budget Policy and Financing 2012

Resolved in the meeting of the working committee on December 7, 2011, and approved in the meeting of the Government Debt Committee on December 15, 2011.

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A significant worldwide slowdown in economic activity is expected for the year 2012: In the **euro area** the willingness to spend and invest will decrease due to public debt crises, the changes in credit ratings, and tensions on financial markets, as well as the increase in uncertainty of economic actors. Export demand will also dwindle as a result of the diminishing momentum of the world economy. Additionally, a weakening of domestic demand can be assumed as a result of the consolidation of public budgets on the backdrop of the debt crisis. The European Commission forecasts real GDP in the euro area to grow by only 0.5% in 2012 (2011: +1.5%). There are downward risks due to the negative interaction among the worsening public debt crises, refinancing problems and the stricter equity capital requirements of banks, and the worldwide diminishing of growth dynamics.

The strained international environment is having a significant effect on **Austria** as a small open economy: While the speedy recovery after the economic crisis of 2009 continued until the middle of 2011, and a very strong economic growth of slightly above 3% on the previous year will be reached in 2011, a considerable slowing of economic dynamics of less than 1.0% on the previous year is expected for 2012. In 2012, demand for domestic export goods will slacken considerably. Additionally, equipment investments will stagnate, as companies will postpone their investment plans because of the bleak economic prospects. Assuming that there will be a slight increase in disposable (real) household income and once again a lower savings rate, private consumption, showing moderate growth, will contribute to stabilizing domestic economic development. In light of consolidation that has already begun, public consumption will increase only to a slight extent.

The strong, quick improvement of the **Austrian labor market** in the years 2010 and 2011 will also be interrupted in 2012: In 2011 the increase in actively employed persons will be approximately 60,000 persons compared with the year before and will thus reach a new high level. At the same time, in 2011 the average number of unemployed persons will decrease by approximately 5,000 persons compared with the previous year. However, at that figure, the number of unemployed is still significantly higher than before the crisis. In 2012 employment growth will considerably slow down, the number of unemployed will rise, and the present unemployment rate of 4.2% will rise to 4.5% (European Commission).

As of 2011 a consolidation course was started in **public budgets** in **Austria**. The goal is to ensure that there will be a gradual reduction of the general government budget deficit to below the EU reference value of 3% of GDP by 2013, to 2.4% of GDP by 2014, and to 2.0% of GDP by 2015, as well as a turnaround of the development of the debt ratio in 2014 (Austrian Stability Program April 2011 and the Strategy Report on the Federal Fiscal Framework Act 2012 – 2015). As reported by the Budgetary Notification of October 2011, Austria's general government deficit will reach 3.6% of GDP in this year (2010: 4.4% of GDP). Government debt will rise from 71.8% of GDP at the end of



2010 to 72.4% of GDP at the end of 2011 according to official information. However, the planned consolidation course for Austria in the present stability program is only partly in keeping with EU requirements.

In November 2011, on the federal government level, a **debt brake for Austria** was decided upon by the Council of Ministers and subsequently consented to by Austria's provinces and local governments in a political agreement. The corresponding proposal for an amendment to the Federal Constitutional Act provided for the following:

- a structural general government budget deficit of maximum 0.45% of GDP starting with 2017 (federal government and social security institutions: 0.35% of GDP; provinces and local governments: 0.1% of GDP),
- letting automatic fiscal stabilizers work,
- exceptions for natural catastrophes and unusual emergency situations, and
- reestablishing a budget buffer ("control account") that allows the deficit to be exceeded by up to 1.6% of GDP (federal government and social security institutions: 1.25% of GDP; provinces and local governments: 0.35% of GDP).

By means of these measures there should be a return to a debt ratio of 60% of GDP by the year 2020. This proposal for a constitutional amendment was not passed in the National Council, as the required two-thirds majority was not reached. However, on December 7, 2011, it was set by law that the federal government is to have a balanced budget by 2017 (Federal Budget Law 2013 section 2 para 4 and section 122 para 6). This principle is considered to be complied with if the structural deficit of the federal government does not exceed 0.35% of GDP.

On the EU level, as early as October 2011, all heads of state and government of the euro countries pledged to implement **national, numerical fiscal rules, preferably in their respective constitutions** by the **end of 2012**. On December 9, 2011, the euro countries agreed to conclude state treaties (**New Fiscal Compact**) in which **numerical fiscal rules** are set on the **national level with constitutional status** or an equivalent level. These regulations must limit the **structural budget deficit of general government** to a maximum of 0.5% of GDP on a national basis and also provide for an **automatic mechanism if this deficit is exceeded**. The **European Court of Justice** will monitor whether the treaty is being implemented on a national level in accordance with treaty provisions.

Numerical fiscal rules for Austria also are in line with the EU Directive on **requirements for budgetary frameworks of the Member States**. This "fiscal framework directive" is a part of the **process to improve economic governance in the EU**, which was started to avoid future economic and debt crises. A comprehensive legislative package ("**six pack**"), which went into effect on December 13, 2011, was developed from this process and it tightened the **rules for the medium-term general government consolidation course**. In particular, the following EU fiscal rules are valid for Austria, unless exceptional rules are to be applied (exceptional events, such as, e.g. natural catastrophes, serious recession):

- As long as the structural budget deficit of the general government is not in conformity with the national medium-term budget objective (MTO) of zero, which Austria has agreed to for a long time, the **structural deficit ratio** must be **reduced by approximately 0.5% of GDP on an annual basis**. If the economy is thriving or if the debt ratio is over 60% of GDP, the adjustment is to be made more quickly. Additionally, the European Commission is drawing up an exact time schedule for the adjustment course.
- Since 2009 Austria has been subject to a procedure due to its “**excessive deficit**” (EDP), which, according to Council recommendations, requires the following:
  - reducing the deficit ratio to **below 3% of GDP by 2013**,
  - reducing the average annual **deficit (structural) of ¾ percent of GDP** in the years 2011 to 2013 and
  - lowering the debt ratio.
- The annual **spending growth of general government** may not exceed the **medium-term growth rate of potential output**, unless discretionary compensation is provided by means of revenue. If the debt-ratio ceiling of 60% of GDP is exceeded, spending growth is to be curbed more rigorously. In Austria spending growth would have to be slightly more than one percentage point below the reference growth rate as long as there is no discretionary compensation due to revenues.
- In **lowering the debt ratio of the general government** it is essential to ensure that the **difference** to the **reference value of 60% of GDP** has been reduced by an average of **one-twentieth** per year in the three previous years. For member states that are subject to an EDP there is a **three-year transition period**. During the transition period the debt criterion is considered to be fulfilled if the respective member state is “making sufficient progress towards compliance with the debt rule”. For Austria, starting with 2014 at the latest, after the EDP has ended in 2013, this implies an accelerated reduction of the debt ratio (2014: at least 73.6% of GDP instead of 75.1% of GDP according to the present Stability Program).
- **Minimum standards for fiscal architecture** in the EU member states (among others national fiscal rules, a budgetary framework with a planning horizon of at least three years, national monitoring and coordination mechanisms, more transparency in the budget management of public budgets and the budgets of publicly-owned organizations under private law), which are to be applied to the national level by the **end of 2013**.

On the basis of the previously mentioned new EU requirements and the currently expected economic framework, the Government Debt Committee recommends the following for 2012:

- To begin to pursue a **consolidation course in 2012** on the backdrop of the international financial economic and public debt crisis. The federal budget estimate for 2012 provides for a Maas-

tricht deficit of 2.6% of GDP. However, the Austrian levels of government (federal government, provinces, and local governments) do not sufficiently fulfill EU requirements, which means that budget discipline on all levels of government must be put into effect quickly. In doing so, the effect of automatic stabilizers should be safeguarded and a procyclical budget policy should be avoided to the extent possible. Additionally, the best credit rating and low interest rate level must not be put at risk because they present an important condition for high employment figures and sustainable growth in Austria. **Consolidation** of public budgets must have preference over **tax reforms**, which are accompanied by a decrease in revenues of the state.

- To embed the government proposal of November 15, 2011, calling for a “**debt brake for Austria**” in its constitution as **quickly as possible**. This would significantly reinforce investor confidence with respect to a solid, sustainable budget policy in Austria and together with the measures to limit risks on financial markets would safeguard Austria’ s excellent credit rating. By implementing the national debt brake, starting with 2017 the structural deficit of the general government of Austria of 0.45% of GDP (federal government and social security institutions: 0.35% of GDP; provinces and local governments: 0.1% of GDP) are not to be exceeded, and the public debt ratio is to be lowered to approximately 60% of economic output by 2020. The “debt brake for Austria”, however, does make allowances for policymakers to smooth **cyclical fluctuations** and to set **labor measures** when the economy is weak. The concept provides for a structural budget deficit of (a maximum of) 0.45% of GDP, for automatic stabilizers to take effect, for exceptions in cases of natural catastrophes and extraordinary emergency situations along the lines of EU rules, and for a budget buffer (“control account”), which is limited in time and should be later again reinstated, that allows the deficit to be exceeded by an additional 1.6% of GDP (federal government and social security institutions: 1.25% of GDP; provinces and local governments: 0.35% of GDP). A debt brake with a budget that is almost balanced throughout the business cycle requires all decision makers in Austria to adapt their way of thinking towards a stability culture.
- To, at long last, achieve a breakthrough in reorganizing **institutional and legal competences in the way all levels of government perform their duties** (“who does what and which instruments are being used”) through a joint effort, in order to make a contribution to reducing the structural budget deficit to 0.45% of GDP on a sustainable basis. As a result of the increase in public debt and the difficult economic situation, **government and administrative reforms** are becoming more **urgent**. In order to return to a debt ratio of 60% of GDP, sound public finances with budget deficits in the vicinity of zero over many years are required. A significant improvement of public finances of all levels of government by means of high revenue growth as a result of a dynamic economic development is not to be expected in the following years. Substantial long-term efficiency gains that enable budget restructuring geared toward expenditures that reinforce growth can only be attained if present weaknesses (duplications, mixed-funding forms, lack of goal orientation, input orientation instead of orientation towards effectivity) are eliminated in the framework of an administrative, federal, and revenue-sharing reform.



- To set the **adjustment path** with the **required measures to reach budgetary targets** (“six pack”, debt brake) for the central government, provinces, and local governments before the new stability program 2011 to 2015 is submitted to the EU and to legally base this adjustment path in a **new, permanent, Austrian Stability Pact** as well as in the **Federal Fiscal Framework 2013 to 2016**. In the course of this process, the requirements of the “EU Fiscal Framework Directive” – in particular budgetary norms (including accounting), medium-term budget plans and their connection to annual budgets, and increased transparency (public reporting requirements) – are to be taken into consideration. These elements are strongly interrelated and can also be complementary. The correct timing of these reform measures will also play a role. Federal objectives and their implementation are in no way in contrast to a stronger focus on the general level of government.
- In **public risk management**, to reinforce risk identification, monitoring and control on all levels of government and to give preference to a stronger and a low-risk, medium-term funding strategy as well as a low-risk investment strategy on all government levels. The difficult situation on financial markets and the low interest rate levels are arguments for measures to avoid concentration of high refinancing volumes, for measures to ensure efficient management of contingency risks, as well for giving long-term funding at fixed interest rates preference. In this connection the Government Debt Committee welcomes the measures taken by the Finanzmarktaufsicht (Financial Market Authority) and the Oesterreichische Nationalbank (Austrian Central Bank) in limiting contingency risks.
- To contribute to making use of the necessary mechanisms to solve the government debt crisis **on the European level** as quickly as possible. In this context it is necessary to involve participants on non-regulated financial markets and to provide the economy with necessary funding. Introducing a financial transaction tax – at least on the euro level – can be considered a contribution to limiting risks. Suitable measures should be taken in accordance with the new EU regulations to reduce macro-economic imbalances. Additionally, budget consolidation steps of the member states should take sufficient consideration of the economic conditions and the labor market situation. Also in the negotiations on the medium-term Financial Framework 2014 to 2020 of the EU, it would be necessary to work toward a configuration that is in keeping with the principles (e.g. growth and employment, budget discipline) agreed upon for the member states.