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What to be Done Now**

Gabriel Felbermayr

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In the last two years, economic policy in Austria has been dominated by the COVID-19 crisis. Concerning its pandemic response, compared to its international peers, Austria ranks only average, both in terms of excess mortality and economic losses. While the pandemic situation is still acute, economic policy must nonetheless refocus on structural issues that are decisive for long-term prosperity. This article highlights some aspects of the COVID-19 crisis and offers some thoughts on the transformation of the energy system and the reform of labour market institutions. The proactive design of both policy areas will be crucial for the country's successful economic future.

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For the last two years, Austrian economic policy has been dominated by the COVID-19 crisis. Now, however, it is time to turn our attention to the transformative tasks ahead.

This paper highlights some aspects of the crisis and offers reflections on the transfor-

mation of the energy system and the reform of labour market institutions. The proactive design of both policy fields will be important for a successful economic future of the country.

1. A crisis of a different kind

The COVID-19 pandemic has been raging for two years now. In the meantime, there have been more than 2.25 million proven COVID-19 infections in Austria; more than 14,000 people have succumbed to the disease. Four waves are already behind us; at the time of writing, a fifth is in progress. Figure 1 shows the hospitalisation rate on the right axis – the number of persons hospitalised with COVID-19 per million population. This curve traces the relevant pandemic event. The higher the rate, the more likely it is that the health system will be overburdened. The visual impression of the dynamics is that of a **rollercoaster ride**.

The grey shading in Figure 1 reflects the intensity of the lockdown measures. Here it is important to remember that despite the general displeasure with the regulatory restrictions, their economic impact is very unevenly distributed. This has been a general feature of the COVID-19 crisis. A few sectors keep losing massive amounts of turnover and value added, be it due to official restrictions, be it due to voluntary behavioural changes on the part of customers. Other economic sectors, however, remain pretty much unscathed, or even go through the crisis with increases in turnover. Such a **dichotomy of economic activity** is usually not

The economic consequences of the COVID-19 crisis are distributed very unevenly between the sectors. Such a dichotomy of economic activity was not observable in earlier crises.

observed in "normal" economic crises, where economic activity tanks more uniformly. The Princeton economist Markus Brunnermeier (Brunnermeier, 2021) speaks of a *K*-recession in this context.

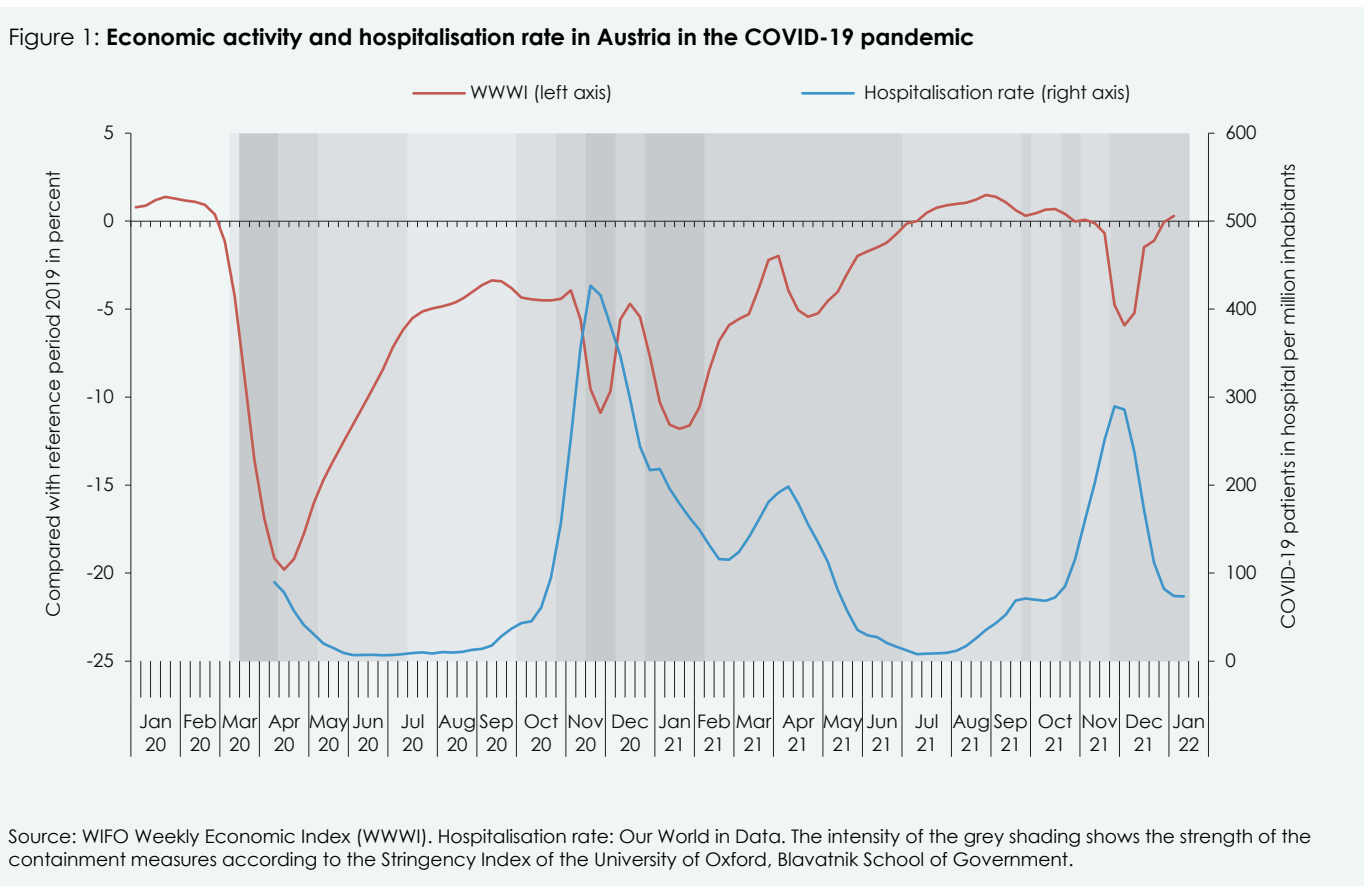
In Austria, comparatively generous state aid helped to mitigate the economic consequences of the crisis and prevent insolvencies.

The various COVID-19 relief measures should be systematically evaluated for their effectiveness, accuracy and costs in order to be prepared for future crises.

The COVID-19 crisis is different. Its **interruptive character** indicates that state aid to companies and the payment of short-time working benefits in the most affected sectors are useful to bridge temporary losses in turnover and earnings or to avoid redundancies and income losses. Austria has so far been comparatively generous in this regard, as the OECD (2021), for example, pointed out in its latest country report¹. In this way, corporate insolvencies could be avoided. In contrast to normal recessions, even fewer companies filed for insolvency in the crisis years 2020 and 2021 than in 2019, across all sectors. In the third quarter of 2021, after the abolition of certain aid measures and the change in certain legal framework conditions², the number of insolvencies picked up compared to the previous year. The increase is concentrated in the crisis sectors of

accommodation and food services, warehousing and transport and, to a much lesser extent, in trade. Nevertheless, even in these sectors, the figures are still below the pre-crisis level. In addition to state aid to businesses, the fact that credit is still very cheap also has a positive effect; in this respect, the low interest rate policy of the European Central Bank is also an important factor in stabilising the economy in the face of repeated closures and other impairments. Conversely, a crisis-induced erosion of the equity base of companies could lead to increased insolvencies when the aid expires and interest rates rise again.

WIFO has already frequently advocated the systematic evaluation of the various COVID-19 aid measures in terms of their effectiveness, accuracy and costs. To this end, the Federal Ministry of Finance should commission evaluation studies and provide the necessary database. Aid instruments have changed a lot over time and it would be good to have evidence-based assessments of their quality for the next crisis³.



¹ It should be noted here that international comparisons are difficult because the countries have used public guarantees to very different degrees; their financial impact on their budgets is not yet foreseeable. In Austria, actual COVID-19-related public disbursements amounted to 15.9 billion € in 2020 and 10.8 billion € in 2021 (first to third quarter), according to Statistics Austria.

² Until the end of June 2021, there was a temporary suspension of the obligation to file for insolvency and an extension of the deadline for filing for insolvency from 60 to 120 days. Thus, companies with temporary payment difficulties were also protected from the risk of liability due to insolvency delay.

³ See also Burton et al. (2021).

Figure 1 shows on the left axis how much the aggregate weekly economic activity differs from the average level of the pre-crisis year 2019. With the exception of only a few weeks in the summer of 2021, economic output was consistently below the pre-crisis level. The Figure suggests four conclusions. First, economic performance and the incidence of infection are negatively correlated. Second, over time, the correlation becomes much weaker: while the first COVID-19 wave caused the sharpest economic downturn in post-war history with a relatively low disease burden, subsequent waves all placed a much heavier burden on the health system with weaker economic losses. Third, periods of severe lockdowns are associated with a drop in economic output. But, fourth, even with official rules rather unchanged, a change in the incidence of

infection can lead to new economic costs, as was shown in April 2021.

The **decreasing correlation** between economic losses and the occurrence of infections is related, on the one hand, to learning effects in the affected industries, in the administration of economic aid, and in the behaviour of citizens, and, on the other hand, to the simple fact that the immunisation level of the population is increasing, whether through vaccinations or through surviving infections. It can be assumed that this dynamic will continue and that the pandemic – despite the continuing risks – will gradually lose its horror, at least for the economy as a whole. Despite the current critical situation, economic policy attention can therefore be refocused on the structural issues that are relevant to long-term prosperity.

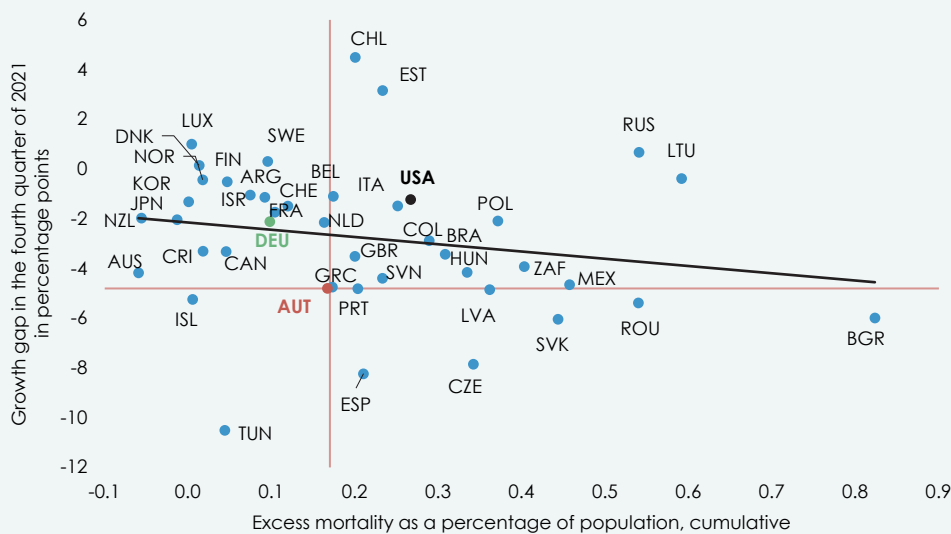
The correlation between the incidence of infection and economic losses has decreased over time. Economic policy attention must once again focus on long-term structural problems.

2. International comparison: Pandemic management in Austria moderately successful

But before we talk about transformation and reforms, the question arises: How has Austria fared so far in international comparison? Although this can only be conclusively assessed after the pandemic lies really behind us, it is already interesting to take a look at excess mortality and the growth losses accumulated since the beginning of the crisis relative to the hypothetical growth path

without the pandemic. Figure 2 shows both variables in one diagram. The excess mortality takes into account, on the one hand, that the pandemic puts the health system under stress and makes it more difficult to treat other diseases and, on the other hand, that the measures to protect against COVID-19 infections also prevent the spread of other contagious diseases.

Figure 2: Growth gap and excess mortality in the COVID-19 pandemic in international comparison



Source: OECD, World Mortality Data Set; WIFO calculations and presentation. $N = 43$ (countries for which the OECD produces a business cycle forecast and for which excess mortality data are available). Excluding Ireland (outlier). Growth gap ... Difference between OECD forecasts of December 2021 and November 2019 for GDP growth fourth quarter of 2021 compared to fourth quarter of 2019.

In international comparison, Austria has so far coped with the pandemic in an average manner, both in terms of deaths and economic consequences.

Without the pandemic, domestic GDP at the end of 2021 would have been about 2.8 percent higher than in 2019; in fact, it is 2 percent lower. The gap to the originally assumed growth path is thus almost 5 percentage points.

WIFO expects the economy to continue to recover in 2022 and GDP to grow by 5 percent year-on-year.

Industry was hit comparatively weakly by the COVID-19 crisis and recovered surprisingly quickly. It is at the centre of the upcoming transformation of the energy system.

The industrial core of the domestic economy seems to be in good shape. The German industrial weakness already existed before the COVID-19 crisis.

In an international comparison, Austria has managed the pandemic moderately so far. Figure 2 shows that Austria has suffered a **cumulative excess mortality of about 0.71 percent of the population** over all previous waves. This puts the country in close proximity to Belgium or the Netherlands. In Germany, Switzerland, Sweden or France, however, the excess mortality rate is one third lower. It is much lower in Finland or Norway, or in East Asian countries. In Australia, New Zealand and Japan, the excess mortality rate is even negative – the containment measures there have saved more lives than the virus has cost.

In addition, there are many countries with higher excess mortality rates than Austria: Italy, the UK or the USA are worth mentioning here, as well as all Eastern and South-Eastern European countries for which reliable data are available.

In terms of the economic impact of the pandemic, **Austria** also lies the **middle** range, but rather in the lower end. On the ordinate of Figure 2, the difference in the projected growth of real GDP (fourth quarter of 2021 versus fourth quarter of 2019) is shown, as resulting from the comparison of the OECD forecasts of November 2019 (before the outbreak of the pandemic) and December 2021. This measure takes into account that countries would have grown without the pandemic, but at different rates. According to the OECD forecast, Austria's GDP at the end of 2021 would have been about 2.8 percent higher than at the end of 2019 without the COVID-19 pandemic; it is actually 2.0 percent lower. In total, therefore, almost 5 percentage points are missing compared to the originally assumed growth

3. Industry: Stagnation after strong recovery

The industrial sector is particularly relevant for economic development because it traditionally shows higher volatility than other sectors and because it holds a central position in the national value network. The sector has been only slightly affected by direct health policy measures during the COVID-19 crisis, but is at the centre of the upcoming transformation of the energy system.

At present, manufacturing is beset by other problems, first and foremost by **material shortages**. In fact, it was the lack of primary products from China and northern Italy that had dampened European industrial production the most at the beginning of the pandemic. Afterwards, however, there was a global recovery kicked in that proved surprisingly fast. Both global trade in goods and industrial production developed in a V-

path. According to OECD estimates, Germany would have grown 1 percentage point slower than Austria without COVID-19 and survived the fourth quarter of 2021 without a lockdown; therefore, the growth gap there is only 2.1 percentage points.

Among the 48 countries for which the OECD regularly makes forecasts, the growth rate is higher than in Austria in 11 cases and lower in 36 cases. In seven countries, GDP is currently even higher than forecast in November 2019 – but this is, of course, not only due to a good COVID-19 policy.

The British weekly magazine "The Economist" recently compared 23 countries in terms of the economic impact of the COVID-19 pandemic. The Scandinavian countries are at the top of the ranking and **Austria in the bottom third**⁴. In all these comparisons, it is important to note that the figures are highly volatile and countries such as Austria, which were hit harder by the fourth wave, are likely to experience a stronger recovery in the coming months.

Despite the current gloom, WIFO expects the economy to continue to recover in 2022 (Ederer & Schiman, 2021). From spring onwards, economic output should grow above the pre-crisis level and stay there. Supported by strong consumption the annual average growth rate of GDP in 2022 should lie at about 5 percent. Uncertainty remains high, however, not only because of the direct impact of the COVID-19 pandemic, but also because of risks in the manufacturing sector and by geostrategic tensions. Fiscal policymakers are advised not to jeopardise the recovery by rushing into budget consolidation.

shape. As early as November 2020, the volume index of world trade exceeded its pre-crisis level; industrial production developed in sync with it. In March 2021, global trade was 6 percent above the pre-crisis level, global industrial production 2.5 percent. Since then, however, both indices have stagnated. The reason is again material bottlenecks and shortages, among others in maritime logistics.

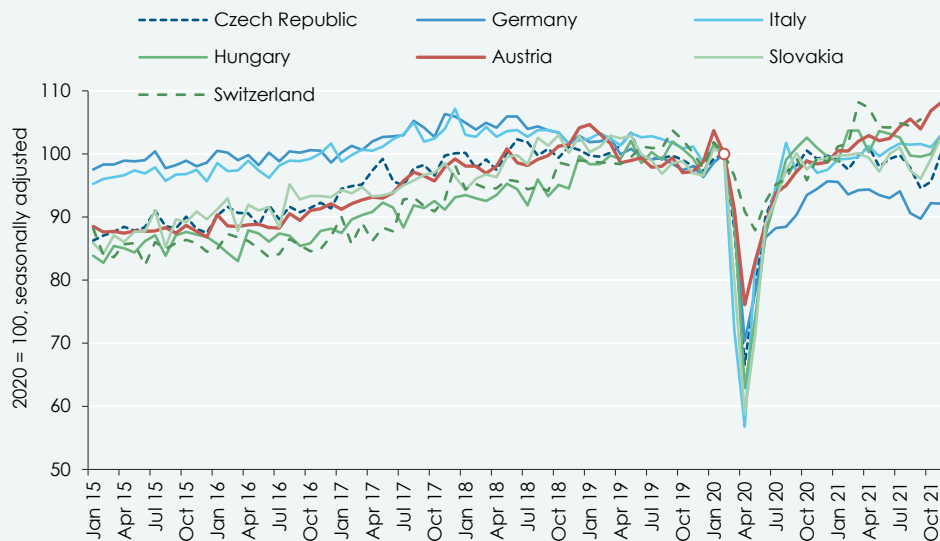
For Austria, at any rate, it is encouraging that the industrial core of the national economy seems to be in good shape despite all the problems. This is shown by the development of industrial production in comparison with neighbouring countries (Figure 3). In Austria, production had plummeted in the first months of the pandemic, but then recovered surprisingly quickly. This is also true

⁴ The Economist (2021, 26 December). Winners and losers. Which economies have done best and worst during the pandemic?. <https://www.economist.com/finance-and-economics/which-economies-have-done-best-and-worst-during-the-pandemic/21806917>.

for the neighbouring countries, for the euro area and the global average. In Austria, however, the recovery continued: the index of industrial production was on average almost 3 percent above the pre-crisis level in the last three months available, while in the euro area it was almost 1.5 percent below. The heavyweights Germany and France are mainly responsible for this development; in

Italy, on the other hand, industrial production is above the pre-crisis level. Since the beginning of the crisis, industrial production has developed more favourably in nine EU countries than in Austria, and more weakly in 16. Austria is therefore in the **upper midfield**. Germany, on the other hand, figures at the rear.

Figure 3: Industrial production in Austria and its neighbouring countries



Source: Eurostat, WIFO calculations and presentation.

Three reasons are relevant to Germany's industrial weakness: first, industrial production in Germany is heavily concentrated in the automotive and engineering sectors, where shortages of materials, especially microchips, are a particularly severe constraint; second, in the value chain, final assembly, where supply problems that occur along the whole chain inevitably accumulate, is often concentrated in Germany; and finally, Germany specialises in the most expensive and technically sophisticated products – a fact that also compounds the problems. But the pronounced weakness of Germany as an industrial location predates the COVID-19 crisis. Industrial production in Germany has already been declining since the end of 2017. Austria was initially able to escape this trend; however, 2019 was already difficult in this country as well. However, Austria was able to benefit significantly more from the revival of demand after the acute phase of the crisis than Germany and other neighbouring countries with the exception of Switzerland.

Because the Austrian economy is so closely linked to the German economy, the question arises as to the future **development in Germany**. Here it is remarkable how much the statistics of incoming orders have decoupled from the production statistics. Overcoming the bottlenecks in German industry can therefore lead to a strong expansion that sweeps the Austrian economy along⁵. However, whether the German industrial boom will also provide lasting growth impulses for Austria is questionable, however, as long as the location problems in Germany are not solved. The programme of the new traffic light coalition displays contradictory elements: on the one hand, the new governments is supposed to be unleash an investment boost, but on the other hand, high energy prices, high taxes, legal uncertainties and the shortage of skilled workers are weighing on the dynamics.

Austria would also benefit from a strong expansion of German industrial production. However, as long as the location problems in Germany have not been solved, no lasting growth impulses can be expected from there.

⁵ For current figures and trends in bilateral, German-Austrian economic relations, see Felbermayr et al. (2020).

4. High prices

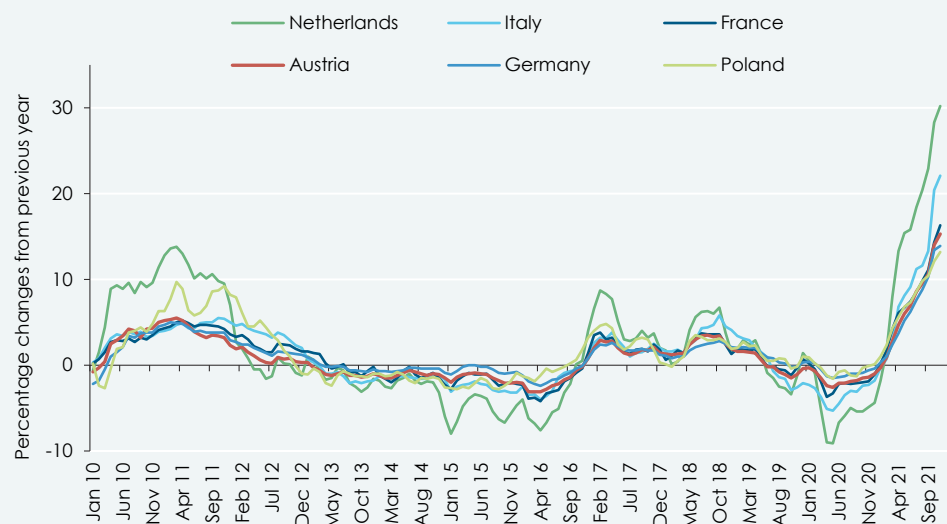
High producer prices are likely to be passed on, at least in part, to consumers in the coming months.

High prices are indeed a growing problem. Figure 4 shows the growth rates of producer prices in manufacturing. In November 2021, prices for industrial products in Austria were 15.3 percent higher than in the previous year – the highest inflation rate since the beginning of the time series. Energy and intermediate metal products in particular drove the index upwards. In Germany and Poland inflation was recently somewhat weaker (+13.9 percent and +13.2 percent, respectively), while in France (+16.3 percent) it was slightly, and in Italy (+22.1 percent) and the Netherlands (+30.2 percent) significantly stronger than in Austria. The dynamics are essentially imported – Austrian producers pay significantly more for raw materials and intermediate products; however, the importance of imported inflation seems to be even more pronounced in other countries.

It seems inevitable that the high producer prices will be passed on, at least in part, to consumers in the coming months. This means that even if energy prices do not rise

further, there is a threat of a further increase in consumer prices. Therefore, WIFO expects an annual average **inflation rate** of 3.3 percent for 2022 and is thus somewhat more pessimistic than the Austrian National Bank or the Institute for Advanced Studies. However, the rates of price increase will be very unevenly distributed across the different product and service categories. Private households with different baskets of goods will therefore be affected to different degrees. In this context, it would be very desirable if public statistics would show inflation rates by income, employment and age groups. This is the only way to get a good estimate of how higher prices change the **risk of poverty** in Austria. In any case, it is foreseeable that rising prices will increasingly also become an explosive socio-political issue. It is therefore to be welcomed that the federal government will return most of the revenue from the new CO₂ pricing in the areas of transport and housing to the population in the form of a flat-rate climate bonus.

Figure 4: **Producer prices in selected EU countries**



Source: Eurostat, WIFO calculations and presentation. Not seasonally adjusted.

The high energy prices reduce above all the purchasing power of the most vulnerable. Low-income households should be supported by a one-off payment.

Apart from the eco-social tax reform, the current high inflation also has important socio-political implications. High energy prices reduce the purchasing power of the most vulnerable, who spend a higher proportion of their income on heating their homes. Although there is no recent evidence on this for Austria, data from other countries give clear indications (Joyce et al., 2022, for the UK). Policymakers should not succumb to

the temptation to intervene by setting maximum prices or price controls, because this would massively distort market activity; nor should they resort to lowering VAT for goods particularly affected by inflation, because this would not be very accurate. Instead, it is recommended to provide one-off financial support to the most vulnerable households⁶.

⁶ The federal government plans to increase the already decided cost-of-living adjustment for the socially needy by another 150 € as well as a one-off

payment of 150 € for persons with incomes below the maximum contribution basis.

At the same time, private households, companies and the public sector should prepare themselves for the fact that inflation rates will probably no longer be as low as before the COVID-19 crisis, even in the long term. The European Central Bank itself has raised its asymmetric inflation target from "below but close to 2 percent" to a symmetric target of 2 percent. In addition, real economic trends such as weaker growth in the global labour supply, new barriers in international

5. Investment as the key to mastering transformation processes

Austria, Europe and the world are struggling with parallel challenges that require a fundamental adjustment of the economic system. First, **climate change** requires an internationally coordinated and ambitious reduction of greenhouse gas emissions, and – after long years of stagnation – in a very short time. Secondly, after many decades, the **growth of the labour force** is coming to an end, both in Austria and in the European neighbourhood. This means fundamentally rethinking labour market institutions (more on this in Chapter 6). And thirdly, the pace of **technological change** is very high, which on the one hand brings opportunities for accelerated wealth creation, but on the other hand also carries the risk of being left behind internationally. It is a matter of substantial concern that the Austrian population seems to show little interest in science and technology compared to other EU countries and that Austrians remarkably often doubt research results on which there is scientific consensus (see the results of the Special Eurobarometer 516).

With the **eco-social tax reform**, the Austrian federal government has set the course for a climate-friendly restructuring of the Austrian economy, even though WIFO criticised the unambitious price path for CO₂ (Kettner-Marx et al., 2021), which will only gradually exert a certain steering effect. At the European level, too, the targets are now clear. The same applies, with particular ambition, in Germany. In other continents, too, economic policy is increasingly geared towards the climate protection target. In China, the world's largest emissions trading scheme in terms of covered emissions volume has been opened, even if the prices are still low. In addition, the Chinese leadership is massively backing battery-electric mobility. In the USA, the situation is less clear; but due to the country's inherent dynamics, in the USA the shift away from fossil fuels can be very quick and consistent if it is economically viable. The question is therefore not so much whether the global transformation of the energy system will happen, but how quickly it can happen, at what cost, and who can take the lead in technology. It is clear that massive investments are needed, for example in the expansion of renewable energy sources and the electricity grids at home

trade or a rise in energy prices in the wake of the decarbonisation of the energy sector are coming up against a continued expansionary monetary policy environment and fiscal policy. In the USA, a more restrictive monetary policy is on the horizon; the euro area is not yet as far along, and in terms of fiscal policy, the expansionary impulses predominate here due to the investment programmes in the wake of climate policy.

and abroad. It is also clear that these investments must come primarily from the private sector. In Austria, about 20 percent of the total investments come from the state, 80 percent from the private sector. Politicians must ensure that the incentives for private-sector investments are high. This requires, among other things, an ambitious CO₂ price, complementary investments in the public networks and an investment-friendly location policy.

In addition to the energy transition, many economies will have to deal with the **ageing of the population** in the coming years. An increase in life expectancy and low birth rates will lead to a decline in the labour force in most EU countries. This will have an impact on labour markets and social security systems. In Austria, the number of job vacancies in relation to the labour force is already as high as it was last in the 1970s; however, long-term unemployment is also becoming entrenched at a high level. In the coming years, it must therefore be possible to activate the labour force by reducing unemployment and especially long-term unemployment; this will require measures to further increase the labour force participation of women, (qualified) immigration and an increase in the average de facto retirement age. Above all, however, the goal must be to equip the decreasing number of workers with better human capital and to renew this regularly through further training. Proposals and political ambition in implementation are urgently needed here.

In general, it can be said that both the energy transition and the demographic changes are immensely helped by **productivity growth** – the aim is to preserve broad prosperity and thus social peace with less use of resources and labour. Technological change will open up opportunities for this. But it should be clear that only through investment can productivity growth really be achieved. Therefore, the best transformation policy is one that facilitates (private sector) **investment**. This requires attractive and reliable fiscal framework conditions. This requires a reliable market design, such as a modernised and expanded emissions trading system, in order to internalise all relevant costs and thus set the right investment incentives.

Inflation is unlikely to fall back to pre-crisis levels even in the long term.

The most important international challenges for economic policy currently include climate change, ageing and technological change.

The transformation of the economy requires massive investment, which must come primarily from the private sector. Politics must create the necessary framework conditions for this.

Given the ageing of the labour force, the shrinking workforce needs to be equipped with better human capital.

The upcoming challenges of transformation need to be met through productivity growth, which in turn can only be achieved through investment.

Finally, it is essential to think in European terms from the outset. Thus, a deepening of the European Capital Markets Union and the realisation of an adequate European electricity market design must be on the

agenda. Political micro-management of the energy transition, e.g. through the EU's taxonomy regulation, is problematic because it opens the door to lobbying and increases economic costs (see Felbermayr, 2022).

6. Elements of labour market reform

The rapid recovery on the labour market was one of the biggest surprises in 2021. But it should not distract from continuing structural problems.

In the COVID-19 crisis, the Austrian labour market came under massive pressure. Although the instrument of short-time work was heavily used, unemployment rose dramatically. In April 2020, there were more than 520,000 unemployed in Austria, almost 230,000 more than in the same month of the previous year (Figure 5). In addition, there were people in training. Since then, however, the number of jobseekers has steadily decreased, apart from a brief interruption in the winter months of 2020-21. In December

2021, the number of unemployed was about 14,000 below the pre-crisis level despite the new lockdown. The number of job vacancies in April 2020 had still been about 27,000 smaller than in the same month of 2019. In contrast, in second half of 2021 it was always more than 30,000 higher than in the same months of 2019. At the same time, the number of people in employment was up to 60,000 higher than in 2019. This favourable development is probably **one of the biggest positive surprises** of the past year.

Figure 5: Unemployment, labour supply and job vacancies



Source: Public Employment Service Austria, Federation of Social Insurances, WIFO calculations and presentation.

However, it should not be missed that in December 2021 about 177,000 people were still registered for short-time work. If the instrument of short-time work did not exist, these people would be at least partially unemployed. But here, too, the positive development cannot be overlooked: in December 2020, 470,000 employees were still registered for short-time work, of which 417,000 cases were actually settled.

The Austrian labour market thus proved to be resilient during the crisis, because after the sharp slump there was a quick rebound.

However, it is not entirely clear yet why this was the case. In any case, the labour supply (sum of employed and unemployed) fell below the pre-crisis level only once during the COVID-19 crisis (December 2020). So it is not that people have withdrawn from the labour force⁷. With higher employment but real economic output at or even below pre-crisis levels, gross value added per worker must have fallen. An important reason for the **relatively good employment situation** is probably that many domestic companies are solidly positioned and want to secure employment for the future, knowing that

⁷ It is conceivable that the hours worked per employee have decreased; no data are available on this yet.

demographic change will make it increasingly harder to find workers. For decades, the labour market was a buyer's market, meaning that employers could often choose between many applicants, while the latter often had few options. At its peak in the summer of 1997, there were almost 20 unemployed persons per job vacancy; currently that rate is below 3 (not counting persons in training). Despite this good news, Austria's unemployment rate of 8.0 percent (2021) is still higher than in the period before the financial market and economic crisis of 2008-09, or than in Germany, for example.

Moreover, structural difficulties on the Austrian labour market threaten to become entrenched. According to the Public Employment Service Austria (AMS), the number of long-term unemployed in 2021 was just over 80,000, almost 30 percent higher than in 2020 and 67 percent higher than the average level in 2019. The number of **long-term unemployed**, which includes people in training or on sick leave in addition to the

unemployed, was also more than 30 percent higher in 2021 than in 2019, at almost 132,000. Any serious labour market reform must primarily address this group of people.

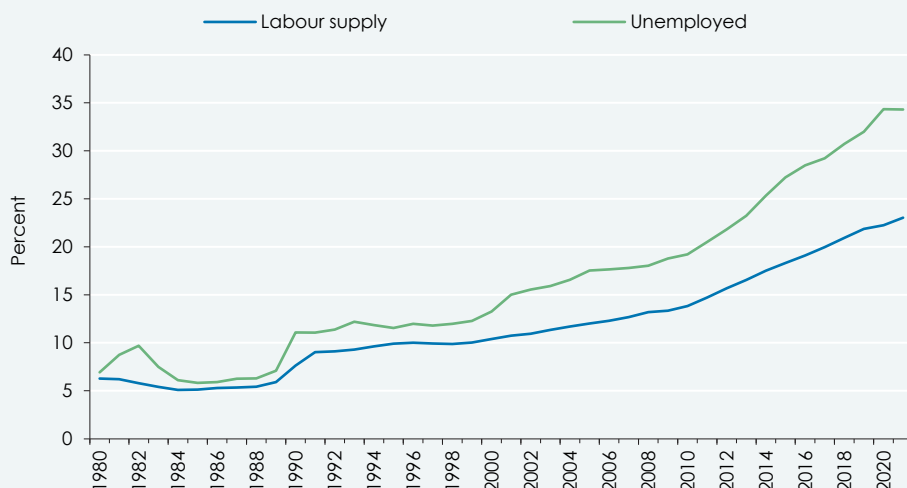
A second group to focus on is **people aged 50 and over**. They make up almost exactly one third of the unemployed; compared to the previous year, unemployment here fell by only 12 percent in 2021, while it fell by almost 21 percent in the 25-49 age group. Unemployment in old age is strongly correlated with long-term unemployment.

A third group of people that must play a central role in any reform project is that of foreign workers. Currently, the share of **persons without Austrian citizenship in the labour supply** is 23 percent, but among the unemployed it is over one third (Figure 6). Since the beginning of the 1990s, the share of foreigners among the unemployed has constantly risen faster than in the labour supply. Any meaningful labour market reform must take this into account.

The number of long-term unemployed in Austria is significantly higher than before the COVID-19 crisis. A higher working age, low qualification and health limitations are among the most important risk factors for unemployment to become entrenched.

Among the unemployed, the share of foreigners has increased more strongly in the long term than in the labour supply.

Figure 6: Share of foreigners in the labour supply and the unemployed



Source: Public Employment Service Austria, Federation of Social Insurances, WIFO calculations and presentation.

For the three groups mentioned above, **qualification measures** and more efficient placement are especially important. A lot is already happening here in Austria; nevertheless, a constant evaluation and further development of active labour market policy measures is necessary. In view of the multiple transformations of the Austrian national economy, higher financial resources than before are certainly also necessary in these areas.

Finally, there is the group of those who, due to chronic illnesses, especially of a psychological nature and especially after the COVID-19 crisis, are no longer available to

the labour market or are only available part-time. Here, the institutions of labour market policy must cooperate efficiently with those of health policy.

It is very welcome that the Federal Minister of Labour is working on a reform, because the reduction of unemployment yields **multiple dividends**. On the one hand, there is a financial relief for the unemployment insurance scheme, opening a path towards a reduction in the contributions to be paid by employees and employers. On the other hand, with increasing employment, the income tax and social security contributions in the public budgets increase. In addition,

More funds should be made available for active labour market policy than before.

Reducing unemployment yields multiple dividends. The financial relief and a reform of the unemployment insurance system could create scope for a reduction in non-wage labour costs.

companies benefit if more workers can be employed because the labour shortage becomes smaller. Finally, happiness research shows that people's life satisfaction increases when they find employment (Frey & Frey Marti, 2010).

At the same time, it should be clear that it is not a political goal to minimise the unemployment rate at all costs. Job changes, even involuntary ones, are important for macroeconomic productivity development, especially in times of transformation. However, sufficient time is needed for good, new labour relations ("matches") to emerge. It makes no macroeconomic sense to force the unemployed to accept jobs that are unsuitable for them. Well-designed unemployment insurance is not only important for distributional reasons, it also increases the efficiency of the economy – i.e. the potential output (Acemoglu & Shimer, 1999).

The central goal of reform efforts must be to improve the **efficiency of the system** in such a way that it can be made more generous at the same (or lower) cost. In addition to adjustments in the structure of unemployment insurance, it could make sense to fully accommodate unemployment assistance in the federal budget, as is the case in Germany. This could roughly halve contributions to unemployment insurance. Such a reduction in non-wage labour costs is a long-standing demand of the WIFO. It would create positive employment incentives and thus be at least partially self-financing⁸.

In a series of studies, WIFO has evaluated labour market institutions and examined reform options. It clearly emerges that the greatest potential lies in improving the placement efficiency of the unemployed. Changes in the structural parameters of unemployment benefits, on the other hand, are less important for the incidence of unemployment⁹. However, they can be very important for the sense of justice, both on the part of the unemployed and the employees who maintain the system with their contributions.

The fact is that in Austria the net replacement rate in the first months of unemployment is low by international standards, but in later months of joblessness it is more generous: the replacement rate for single people falls from 55 percent for a duration of unemployment benefit of 12 months at most (longer for training) to 52.5 percent (unemployment assistance) for an indefinite period. It is also well documented that a relatively high proportion of the unemployed are re-employed by the previous employer after a short period of time (Eppel et al., 2018). This "parking" in unemployment

accounts for about 1 percentage point of the unemployment rate and could be an indication of consensual abuse of the system. Workers might also deliberately plan for a period of unemployment when they have already decided to move to a new employer.

Finally, it is possible for unemployed people in Austria to earn additional income tax- and social security-free up to the marginal earnings limit of about 486 € (2022). This regulation is relatively generous in international comparison. In Germany, for example, unemployment benefits are reduced from an additional income of 165 €. In Austria, in the case of low incomes, it can happen that an unemployed person with unemployment benefit and marginal employment has more net income than in an employment relationship subject to full social insurance, although in the first case no social insurance contributions are paid.

An important message from the WIFO studies is that a **coordinated reform package** is needed; isolated measures are of little help because there are interactions between the individual institutional parameters of the system that need to be taken into account. For example, raising the net replacement rate, e.g. from 55 percent to 70 percent (as demanded by the trade unions) could make short-term "parking" in unemployment appear even more attractive. An excessive restriction of the additional earnings limits could in turn cause the unemployed to lose contact with the world of work or to turn to undeclared work.

An important element of the reform could be to increase the **incentive compatibility** of the system. For example, it would certainly make sense to reduce the so-called moral hazard, which automatically arises with any insurance, on both the employee and employer side. This means reducing the incentives to bring about the insured event. In return, one could make the employers' contribution payments more flexible and increase the net replacement rates for the employees. On the employer side, contributions to unemployment insurance could be made dependent on behaviour: those who frequently produce unemployment pay higher contributions, those who rarely do so pay lower ones – all this with a slightly reduced contribution burden overall. The literature refers to this as "experience rating" (see Eppel & Mahringer, 2020). On the employee side, in the first month of unemployment, unemployment benefits could initially only be paid in hardship cases; in the next five months, on the other hand, 70 percent (instead of 55 percent so far) of the previous net earnings would then be paid. In this model,

⁸ Of course, there are many different ways to finance a reduction in non-wage labour costs, e.g. by raising the maximum contribution base (Guger et al., 2008).

⁹ See for example Eppel et al. (2016) and Böheim et al. (2017).

An important element of reform is to improve the incentive compatibility of the system in order to reduce undesirable behaviour on the part of employers and employees.

someone who has been unemployed for six months would receive about 6 percent more wage replacement than before. For longer periods of unemployment, the current replacement rate could be maintained or increased to the German level (60 percent), and after 12 months it could be reduced to the current level of unemployment assistance. This construction would significantly reduce the attractiveness of short-term "parking" of workers in unemployment or "taking along" unemployment benefits in case of a planned change of job. Roughly calculated, a halving of these undesirable phenomena would already be sufficient to

counter-finance the somewhat more generous design of unemployment insurance presented above.

With regard to **additional earnings opportunities**, it should be considered whether these should not be significantly reduced (possibly even abolished altogether) in the first six months of unemployment (with higher replacement rates, see above) and then at least made subject to social insurance contributions. This should increase the incentives to quickly take up employment that is fully subject to social insurance contributions.

Supplementary income opportunities could initially be severely restricted to encourage the unemployed to quickly take up employment that is fully subject to social security contributions.

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