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Options for the Consolidation of Public Budgets in Austria

Starting Point and Prerequisites for Success

The financial market and economic crisis entailed considerable costs for the public budgets, namely stimulus programmes, measures taken to support the financial market, and automatically increased expenditure and deficiencies in receipts. They increase the structural budget deficit existing already before the crisis. As a recovery of the economy becomes increasingly evident, the medium-term consolidation of the public budgets is high on the agenda. The Maastricht deficit, according to the current Austrian Stability Programme, is to be lowered from 4.7 percent of GDP in 2010 to 2.7 percent in 2013. Against this background, WIFO is presenting options for the consolidation of the budget based on a strategic approach. They not only aim at reducing the public debt, but also at increasing the efficiency of public expenditure, and at supporting a new alignment of economic and political priorities as well as a more growth- and employment-friendly tax structure.

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Budget policy has decisively cushioned the recession following the financial crisis in 2008-09, thereby accepting an increase of public debt plus an increase of the expenditure ratio. As there is growing evidence for an improving economic performance, the consolidation of public budgets is high on the agenda. Already before the crisis, part of the Austrian budget deficit was structural, i.e., existed irrespectively of the cyclical conditions. In the course of the crisis, the overall deficit, due to automatic stabilisers (decrease of tax receipts, increase of expenditure), and additional stimulus programmes (including carrying forward the tax reform), became larger. Also the debt ratio rose again above the limit of 60 percent of GDP fixed in the European Stability and Growth Pact, which it had surpassed only once (in 2007) since the beginning of the 1990s. The share of government expenditure in GDP rose by 2 percentage points to 51.8 percent in 2009.

The updated stability programme

By mid-September 2009, the European Commission requested the member countries to formulate an exit strategy from the measures set to stimulate the economy in the recession following the financial market crisis as from 2011. In November 2009, the European Commission recommended that Austria reduce the deficit again to under 3 percent of GDP in yearly steps of 0.5 percent to 0.75 percent of GDP until 2013. The Austrian Stability Programme as updated at the end of January 2010 accordingly aims at reducing the deficit to 2.7 percent of GDP by 2013. By doing so, the rise of the debt ratio is to be curbed: instead of well over 78 percent as originally expected the debt ratio is to be stabilised at about 74 percent of GDP by 2013. Following that budget path, the deficit of total government as from 2011 ought to shrink, depending on the actual development in 2010, and with annual technical fine-tuning measures, by about € 2 to 3 billion per year.

On 9 March 2010, a consolidation package to reduce the deficit in 2011 by € 4.2 billion was announced by the federal government, 60 percent of which should consist of expenditure cuts (including the envisaged contribution by the federal provinces amounting to € 2.5 billion), while 40 percent of the consolidation volume (€ 1.7 billion) should be attained by tax hikes. The consolidation volume is higher than the amount required to realise the budget path as specified in the Austrian Stability Programme. This stands to reason, since, on the one hand, any savings need yet to be specified and implemented (amongst others, in the federal provinces), and because, on the other hand, it is important to create, in the period of consolidation, additional leeway for strategic priorities (the Active Component as outlined below), as well as for unforeseen events. Within the framework of that agreement on the consolidation volume for 2011 and its structure the individual federal ministries will be allocated maximum budgets as well as consolidation targets for the medium-term financial framework 2011 to 2014 to be passed in spring. For 2011, these provisions generally translate into cuts vis-à-vis the financial framework 2009 to 2013. Even though these cuts are below average in research and education, the accents are too weak for the medium-term goals set, especially in research and science, education, and climate protection. On the other hand, it is intended to raise efficiency reserves by way of inter-ministry reform programmes (administration and state reform). The next steps – introducing a financial framework bill to be submitted to the national council by the end of April, reporting detailed consolidation measures to the EU (beginning of June), and compiling a draft budget for 2011 (according to the federal constitution due by the end of October) – should also reflect reform steps to be taken within public administration.

Necessity of budget consolidation

The necessity of a medium-term budget consolidation is substantiated and argued as follows:

- The deficit path adopted in spring 2009 would have entailed a rise of the interest expense from 2.6 percent of GDP in 2008 to 3.6 percent of GDP in 2013 (from about € 7 to 11 billion). Even if the consolidation goals according to the budget path as agreed on by end-January 2010 are complied with, the interest expense until 2013 will still rise to 2.9 percent of GDP (€ 9 billion).
- High government debt may impair the creditworthiness of a country and may thus raise risk premia on the interest rates on government bonds. The high indebtedness of most countries and their increasing demand for credit generally exert pressure on interest rates and thus make public debt more expensive for all countries (and consequently possibly for private investors, too).
- High government debt may, furthermore, hamper economic growth, if the increase in interest rates crowds out private investment, if the loans taken out are used to finance public consumption, or if they are used inefficiently in the case of public investment.
- Government debt may have undesirable distributive effects (at the expense of the low income brackets; *Guger et al.*, 2009; the incidence of government debt, however, so far has not been empirically studied).
- High government debt decisively reduces the government's room for manoeuvre, with respect to the scope for counter-cyclical action as well as regarding the potential of raising the growth path, making ecological investment, and guaranteeing the expenditure required in the long run to cope with the consequences of the projected demographic changes.

The character of the consolidation options developed by WIFO

Against this background, WIFO has developed options as to the pace and nature of the consolidation measures to be taken in Austria. Both the pace of the consolidation of public budgets and the choice of the potential instruments are primarily subject to political decisions.

The options presented are based on a strategic consolidation approach. Its goal is not only the reduction of the additional debt accrued to counteract the crisis, but also the increased efficiency of government expenditure, the support of the re-alignment of the (economic and) political priorities, and the achievement of a more growth- and employment-friendly tax structure. It will remain the ultimate goal of budget consolidation to regain the room for manoeuvre and head for a highly competitive, dynamic economy along with a high employment rate. Consolidation measures, therefore, should not be undifferentiated, but be oriented at the issues at hand, at efficiency and incentive effects as well as external effects. A consolidation strategy, therefore, must not – even if it necessarily must reduce budget deficit and debt – contradict the other economic and political goals too much. Ideally, a strategic consolidation may also contribute to the long-term structural reforms required.

The consolidation of the public budget is an important but not the only big challenge economic policy is facing. Medium-term growth will, even if the economic performance at home and abroad improves again, be too low for the unemployment rate to decrease. According to the medium-term forecast of WIFO the real growth rate will be, on average, 1.8 percent p.a.[1] in the period of 2010 to 2014 with an unemployment rate (according to the Austrian definition) of somewhat above 8 percent. Longer-term goals such as the containment of the climate change will require additional action, and in many instances the economic policy has not yet reacted to the issues that have triggered and intensified the crisis. Ageing has not been accounted for adequately, neither with regard to the social or health systems nor in the labour market. A sustainable budget consolidation should, therefore, consider all these requirements in their interdependencies as well as possible. A strategic budget consolidation approach should bear in mind the consequences for the labour market, provide incentives for education and training, research, and the creation of age-adequate jobs and working environments, as well as for the attainment of climate goals, and it should avoid future burdens for the public budget.

Despite other significant goals of economic policy the study submitted by WIFO explicitly focuses on the options for budget consolidation. Concepts effecting higher employment rates and economic growth, enhanced sustainability of the economic system and financial market regulation – above all by way of improved and international regulations – would go beyond the scope of the present study. They have, partly, been worked out[2], or are yet to be worked out in the course of further studies and deliberations; a comprehensive post-financial market crisis strategy for economic policy would not be feasible within the limits of a budget consolidation concept.

National and international environment

The framework conditions for the envisaged budget consolidation are not easy, as many countries take similar steps at the same time. The budget consolidation must be designed in such a way that the propensity to invest and consume rises (as saving rates drop), to compensate for the retrenchment of government expenditures and thus to leave overall economic unaffected. Empirical studies show that a compensation of the negative direct demand effects of cuts in public expenditures is possible, and even probable under certain circumstances. With these conditions in mind, the present study shows and assesses the options available for budget consolidation.

A decisive success factor for budget consolidation is the European environment. The EU's trade policy, both vis-à-vis the neighbouring countries and China, may well contribute to success. As regards research, education, and social cohesion, the Active

[1] *Baumgartner – Kaniovski – Pitlik* (2010): on average, economic growth from 1998 to 2008 was 2.4 percent p.a.

[2] Such as the WIFO White Paper on Growth and Employment (*Aiginger – Tichy – Walterskirchen*, 2006) or the study "Ziele und Optionen der Steuerreform" (*Aiginger et al.*, 2008), and the special issue of the Austrian Economic Quarterly on the financial market and economic crisis (*Böheim*, 2009, *Breuss*, 2009, *Hahn*, 2009, *Hölzl*, 2009, *Mahringer*, 2009, *Pitlik – Schratzenstaller*, 2009, *Url*, 2009, *Walterskirchen*, 2009).

Component of the EU policy (the Lisbon strategy as amended) must be continued and intensified also in a phase of budget consolidation. One consequence of the crisis must consist of an improved national and international regulation of financial markets. The pioneer position in the environmental and energy policies should not be abandoned, but reinforced, despite the disappointing results of the Copenhagen Summit from the climate point of view and also because of the associated economic chances for Europe.

Proviso of cyclical conditions

The recommendations concerning budget consolidation made by the European Commission, the Austrian Stability Programme, and the present study are based on the premises that the recovery of the economy is too weak to stabilise the labour market, but that the growth of the economy will be, on EU average, 1 percent to 2 percent, that of the world economy 3 percent in 2011. Whether these rates will be reached depends on possible crises in individual countries and/or larger enterprises as well as crises in certain sectors or bankruptcy waves. The financial markets have not yet been stabilised, de-stabilising speculation activities are still going on, and regulation systems have not yet sufficiently been reformed. The consensus not to impose any austerity measures yet so as not to endanger the upcoming revival of economic activities is not being complied with, amongst others because of the extraordinarily high deficits of the southern Euro countries. Nor have, in some instances, all stimulus programmes been fully implemented. Too early a start-up of the budget consolidation or the failure of using funds now available for programmes to further growth and employment will result in a rising unemployment rate and a dampening of growth at the beginning of the consolidation period. Then the envisaged budget consolidation would be at jeopardy, and – like a deterioration of the national and international economy – require new deliberations.

Initial situation

Medium-term development of public debt in Austria: forecasts and causes

The forecasts for the medium-term development of public debt in Austria as given in the federal draft budget 2009-10 presented by the Federal Ministry of Finance by the end of April 2009, and the medium-term financial framework for the years 2009 to 2013, as well as the updated Austrian Stability Programme for the period of 2008 to 2013, which was presented at the same time, are understood here to be the medium-term budget path without consolidation measures (Table 1)[3].

Accordingly, the overall Maastricht deficit rose from almost 0.4 percent of GDP in 2008 to 3.5 percent of GDP in 2009. In 2010 and the subsequent years it will reach 4.7 percent of GDP, and will decline slightly to 3.9 percent of GDP as late as 2013. The debt ratio, which could be reduced in 2007 for the first time in 15 years below the Maastricht benchmark of 60 percent of GDP, is forecast to rise, in the absence of consolidation measures, to 78.5 percent of GDP by 2013.

At the end of January 2010 the Federal Ministry of Finance published the updated Stability Programme for the years 2009 to 2013, according to which the budget deficit in the years 2011 to 2013 will be lower than originally expected, due to consolidation measures not specified in detail, primarily on the expenditure side. In compliance with the recommendations of the European Commission to push the budget deficit in annual steps of between 0.5 to 0.75 percent of GDP under 3 percent of GDP by 2013, the budget balance in 2013 is to come to –2.7 percent of GDP (Table 1). Preliminary figures for 2009 show that the public deficit, at 3.5 percent of GDP, corresponded to the figures forecast in spring 2009. Debt levels rose, by 2 percentage points, however, less pronounced than expected in 2009 (to 66.5 percent of GDP) because the recapitalisation measures for banks as budgeted were not fully made use of; for that reason, and due to the consolidation measures envisaged, it will rise to 74.3 percent instead of 78.5 percent of GDP by 2013.

[3] See for the following analyses *Schratzenstaller* (2009).

The increase of the debt ratio as forecast cannot only be attributed to the additional debt accrued in the years to come, but also to the government aid granted to the bank sector, which is deficit-neutral, but increases public debt. However, these recapitalisation measures are intended to raise the debt level only temporarily, until they are finally paid back as from 2014 on. At the end of 2009, therefore, the debt level was increased by € 5.71 billion by these measures (2 percent of the 2010 GDP, or 1.8 percent of the 2013 GDP).

Table 1: Public deficits and debt until 2013

	1995	2000	2005	2007	2008	2009	2010	2011	2012	2013
					As a percentage of GDP					
Excluding consolidation measures										
Structural budget balance general government	–	–	–	–	– 1.3	– 2.9	– 3.8	– 3.7	– 3.8	– 3.3
Primary balance	– 1.8	1.8	1.3	2.2	2.1	– 0.7	– 1.7	– 1.5	– 1.3	– 0.4
Maastricht balance by legal entities										
General government	– 5.8	– 1.7	– 1.6	– 0.5	– 0.4	– 3.5	– 4.7	– 4.7	– 4.7	– 3.9
Federal government	– 5.2	– 1.7	– 1.8	– 0.6	– 0.6	– 3.2	– 4.1	– 4.1	– 4.2	– 3.7
Länder (excluding Vienna)	+ 0.1	+ 0.1	+ 0.1	+ 0.1	+ 0.1	– 0.2	– 0.4	– 0.3	– 0.2	– 0.1
Communities (including Vienna)	– 0.5	+ 0.1	+ 0.1	+ 0.1	+ 0.1	– 0.1	– 0.1	– 0.1	– 0.1	± 0.0
Social security entities	– 0.1	– 0.1	– 0.0	– 0.1	– 0.0	± 0.0	– 0.1	– 0.2	– 0.2	– 0.1
Public debt	68.3	66.5	63.7	59.4	62.5	68.5	73.0	75.7	77.7	78.5
Including consolidation measures										
Structural budget balance general government					– 1.8	– 2.6	– 3.9	– 3.1	– 2.4	– 1.7
Primary balance					2.2	– 0.7	– 1.8	– 1.2	– 0.4	0.2
Maastricht balance by legal entities										
General government					– 0.4	– 3.5	– 4.7	– 4.0	– 3.3	– 2.7
Federal government					– 0.6	– 3.0	– 4.1	– 3.7	– 3.2	– 2.7
Länder (excluding Vienna)					0.1	– 0.3	– 0.3	– 0.2	– 0.1	0.0
Communities (including Vienna)					0.1	– 0.2	– 0.2	– 0.1	0.0	0.0
Social security entities					0.0	0.0	– 0.1	0.0	0.0	0.0
Public debt					62.6	66.5	70.2	72.6	73.8	74.3

Source: Statistics Austria, Federal Ministry of Finance. As from 2009 according to the Austrian Stability Programme 2008 to 2013 as of April 2009 (excluding consolidation measures) and Stability Programme 2009 to 2013 as of January 2010 (including consolidation measures).

Off-budget debt and guarantees

A comprehensive assessment of government debt must, moreover, take into account the high volume of liabilities not included in the debt figures for the general government. The enterprises outsourced by the government reported, by end-2008, debt figures of almost € 23 billion (well over 8.2 percent of the 2008 GDP); the Austrian railways ÖBB accounted for the largest share (€ 11.1 billion), followed by the road maintenance company ASFINAG (almost € 10 billion). The programmes laid out for road and rail construction will increase these liabilities (which are from the point of view of the federal government contingent liabilities, which the government is liable for if need be) to € 32 billion (11.3 percent of the 2010 GDP, or 10.3 percent of the 2013 GDP) by 2010. In addition, the debts accrued by outsourced community and provincial agencies and entities (mainly hospitals) not included in the budgets of the regional administrative entities must be considered.

Also the guarantees on behalf of federal government and the Länder must be allowed for. They rose significantly on the federal level due to the guarantees granted to the banking sector (almost € 108 billion in 2008, almost € 121 billion in 2009, thereof some € 70 billion for exports liabilities, € 29 billion for measures taken to stabilise the financial market, almost € 10 billion for outsourced agencies and entities, especially the road maintenance company ASFINAG and the rail infrastructure company SCHIG). Also on the provincial level the guarantees partly reached a considerable level.

The increase of the debt level in the years to come is to be seen in the light of the considerable budgetary costs of the financial and economic crisis. They are made up of the stimulus programmes by the federal government and the provinces (accelerated tax reform in 2009, Stimulus Packages I and II, stimulus measures of the Länder), the automatic stabilisers, especially revenues from cyclically-sensitive taxes as well as expenditures (particularly unemployment benefits and social aid) as well as the expenditure for the stabilisation of the financial markets mentioned before.

The development of the deficit and of the nominal GDP is decisive for the longer-term development of debt ratios. The debt ratio will increase the faster, ceteris paribus, the higher the annual deficit and the lower the nominal growth rate. For Austria, the European Commission expects an increase of the debt rate to 85 percent until 2020, and to 120 percent to 140 percent of GDP until 2035, if no consolidation measures are taken (i.e., if the deficits as originally forecast by the federal government materialise) and the economic growth does not surpass the trend value of 1.7 percent p.a.

Deficits before the crisis: structural component

The development of the structural deficit expected for the years to come, however, shows that the deterioration of the debt situation is not only a result of the recession and the rather moderate growth even after the crisis will have been overcome. As early as 2008, the structural deficit amounted to 1.8 percent of GDP. In line with the original budget path it is to rise to 2.9 percent of GDP in 2009, and to about 3.8 percent of GDP in the subsequent years to slightly return to 3.3 percent of GDP as late as 2013. The consolidation scenario of the updated Stability Programme as of January 2010 foresees an increase of the structural deficit to 2.6 percent of GDP in 2009, and 3.9 percent of GDP in 2010; in the subsequent years, it is to be gradually reduced to 1.7 percent of the 2013 GDP by consolidation measures.

Not only permanently effective measures to stimulate the economy such as the accelerated tax reform in the year 2009 (2013: 1 percent of GDP) contribute to the emergence of the structural deficit. Of considerable impact are further revenue and expenditure measures taken since spring 2008 independently of the crisis (Table 2). Open-end and partly increasing costs particularly accrue owing the decisions taken by the National Parliament on 24 September 2008 shortly before the last parliamentary elections (the volume will rise to 0.6 percent of GDP until 2013), as well as the anti-inflation package of spring 2008 (2013: 0.1 percent of GDP). Over and above, the rapidly increasing expenditures of the past years for long-term care, pensions, and families contribute to the structural deficit, even if no exact figures are available as to the amounts spent. And there is also the continuous postponement of fundamental structural reforms so as to enhance efficiency within the public sector (*Government Debt Committee*, 2009). Here, the health and school systems, government aid, public administration (including the provinces[4]), and the distribution of tasks and their funding on the governmental levels are concerned. The unwillingness to reform the latter was eventually reflected in the revenue sharing act 2008 to 2013 that improved funding of the provinces (hospitals, long-term care, and education) without any structural (expenditure-saving) provisions being linked thereto (*Schratzenstaller*, 2008).

In the long run, public budgets will encounter further structural obligations, especially in view of the ageing population: thus, the demographic change as expected will entail, according to current EU forecasts for Austria, additional public expenditure for long-term care, pensions and health of about 3.5 percent of GDP until the year 2060. *Kramer* (2009) estimates the additional expenditure for pensions, health, long-term care, education, and protection of the environment, as compared to the start-up situation 2007 (and 2010), to amount to 3.5 percent of the 2020 GDP, and more than 8 percent of the 2035 GDP.

The European Commission, too, expected in its autumn forecast 2009 that Austria would, in the years 2009 to 2011, like nearly all the other EU countries, surpass the deficit limit of 3 percent of GDP (Table 3). The Austrian deficit is below EU average in all three years. Other small EU countries – especially the Scandinavian countries – that made better use of the good economic situation before the outbreak of the crisis to consolidate the budget than Austria, will show, in the years 2009 to 2011, a clearly lower deficit, and will not surpass the Maastricht benchmark of 3 percent of GDP in any of these years. Also with regard to the second indicator for the debt

[4] The Länder are partly in default of implementing overdue reforms, so as with the pensions reform for the civil service, which compares financially on equal terms with the pensions scheme of the federal government.

situation, the debt ratio, Austria is in a comparatively favourable position with 77 percent of GDP in the year 2011.

Table 2: Budget effects of stabilisation measures

	2008	2009	2010	2011	2012	2013
			Million €			
National Parliament decisions of 24 September 2008	623	1,062	1,149	1,375	1,606	1,753
Abolition of university tuitions		157	157	157	157	157
Introduction of 13th family allowance	250	250	250	250	250	250
Increased long-term care allowance		127	135	143	151	159
Higher pension increase 2009 (+3.4 percent instead of +3.2 percent)		53	53	53	53	53
Accelerated pension increase	130					
One-time heating costs transfer to low incomes	50					
One-time payments to pensioners 2008	193					
Prolongation of provisions for long-time employees				150	300	360
Abolition of waiting period for first pension increase		43	88	136	186	238
Increase of contribution times for long-time employees		24	27	27	28	32
Reduction of VAT for medical drugs		270	289	309	331	354
Tax exemptions		138	150	150	150	150
Financial market stabilisation package	900	10,130	– 255	– 720	– 690	– 660
Expenditure (participation capital)	900	10,300	500			
Revenues (guarantee fees, dividends)		– 170	– 755	– 720	– 690	– 660
Stimulus Package I		105	105	75	75	75
Continued internationalisation offensive		25	25	25	25	25
Allocation of "mittelstand" funds with aws		40	40			
Austrian Federal Railways (ÖBB) investment		10	20	30	30	30
Broadband technology		10				
Increase of tax premiums for building society savings		20	20	20	20	20
Stimulus Package II		250	448	423	173	73
Accelerated depreciation (gross)			250	350	100	0
Regional offensive		75	75			
Mandatory pre-school year as from autumn 2009		25	73	73	73	73
Additional funds for research and development		50	50			
Promotion of thermal renovation		100				
Tax Reform 2009		2,135	2,858	3,000	3,060	3,060
Tariff reform		1,900	2,300	2,300	2,300	2,300
Tax relief for families with children		235	488	510	510	510
Introduction of tax exemptions for business incomes, net[1]		0	0	110	150	150
Tax allowance for donations		0	70	80	100	100
Labour market package		220	220			
"Scrap premium"		23				
"Anti-inflation Package" (spring 2008)	164	308	308	308	308	308
Reduction of employers' labour costs (reduced contributions to unemployment insurance for low incomes)	144	288	288	288	288	288
Raised mileage allowance and commuters' allowance	20	20	20	20	20	20
Total	1,687	14,233	4,833	4,461	4,532	4,609
As a percentage of GDP	*0.6*	*5.1*	*1.7*	*1.5*	*1.5*	*1.5*

Source: Federal Ministry of Finance, Austrian Stability Programme for the period 2008 to 2013. – [1] Easing following introduction of deductible allowance for earnings less charges following abolition of taxation benefit of withheld earnings.

The EU-15 average debt ratio for 2011 is estimated at 86.4 percent of GDP, the EU-27 debt rate at 83.7 percent. Owing to the crisis, the debt level in relation to GDP in Austria, like in almost all the other member countries[5], will be higher in the year 2011 than in 2005. The IMF expects a deficit of 5.6 percent of GDP for Austria in 2010; the debt ratio is to reach 82.9 percent of GDP in 2013.

[5] Exceptions are Sweden, Denmark, Bulgaria, and Cyprus.

Table 3: Public deficits and debt in the EU countries

	Maastricht balance					Public debt				
	2005	2008	2009	2010	2011	2005	2008	2009	2010	2011
	As a percentage of GDP									
EU 27	*– 2.4*	*– 2.3*	*– 6.9*	*– 7.5*	*– 6.9*	*62.7*	*61.5*	*73.0*	*79.3*	*83.7*
EU 15	– 2.4	– 2.2	– 7.0	– 7.6	– 7.0	64.2	63.9	75.4	81.8	86.4
Belgium	– 2.7	– 1.2	– 5.9	– 5.8	– 5.8	92.1	89.8	97.2	101.2	104.0
Germany	– 3.3	+ 0.0	– 3.4	– 5.0	– 4.6	68.0	65.9	73.1	76.7	79.7
Greece	– 5.2	– 7.7	– 12.7	– 12.2	– 12.8	100.0	99.2	112.6	124.9	135.4
Spain	+ 1.0	– 4.1	– 11.2	– 10.1	– 9.3	43.0	39.7	54.3	66.3	74.0
France	– 2.9	– 3.4	– 8.3	– 8.2	– 7.7	66.4	67.4	76.1	82.5	87.6
Ireland	+ 1.7	– 7.2	– 12.5	– 14.7	– 14.7	27.6	44.1	65.8	82.9	96.2
Italy	– 4.3	– 2.7	– 5.3	– 5.3	– 5.1	105.8	105.8	114.6	116.7	117.8
Luxembourg	± 0.0	+ 2.5	– 2.2	– 4.2	– 4.2	6.1	13.5	15.0	16.4	17.7
The Netherlands	– 0.3	+ 0.7	– 4.7	– 6.1	– 5.6	51.8	58.2	59.8	65.6	69.7
Austria	– 1.6	– 0.4	– 4.3	– 5.5	– 5.3	63.9	62.6	69.1	73.9	77.0
Portugal	– 6.1	– 2.7	– 8.0	– 8.0	– 8.7	63.6	66.3	77.4	84.6	91.1
Finland	+ 2.8	+ 4.5	– 2.8	– 4.5	– 4.3	41.8	34.1	41.3	47.4	52.7
Denmark	+ 5.2	+ 3.4	– 2.0	– 4.8	– 3.4	37.1	33.5	33.7	35.3	35.2
Sweden	+ 2.3	+ 2.5	– 2.1	– 3.3	– 2.7	51.0	38.0	42.1	43.6	44.1
UK	– 3.4	– 5.0	– 12.1	– 12.9	– 11.1	42.2	52.0	68.6	80.3	88.2
Bulgaria	+ 1.9	+ 1.8	– 0.8	– 1.2	– 0.4	29.2	14.1	15.1	16.2	15.7
Czech Republic	– 3.6	– 2.1	– 6.6	– 5.5	– 5.7	29.7	30.0	36.5	40.6	44.0
Estonia	+ 1.6	– 2.7	– 3.0	– 3.2	– 3.0	4.6	4.6	7.4	10.9	13.2
Cyprus	– 2.4	+ 0.9	– 3.5	– 5.7	– 5.9	69.1	48.4	53.2	58.6	63.4
Latvia	– 0.4	– 4.1	– 9.0	– 12.3	– 12.2	12.4	19.5	33.2	48.6	60.4
Lithuania	– 0.5	– 3.2	– 9.8	– 9.2	– 9.7	18.4	15.6	29.9	40.7	49.3
Hungary	– 7.9	– 3.8	– 4.1	– 4.2	– 3.9	61.8	72.9	79.1	79.8	79.1
Malta	– 2.9	– 4.7	– 4.5	– 4.4	– 4.3	70.2	63.8	68.5	70.9	72.5
Poland	– 4.1	– 3.6	– 6.4	– 7.5	– 7.6	47.1	47.2	51.7	57.0	61.3
Romania	– 1.2	– 5.5	– 7.8	– 6.8	– 5.9	15.8	13.6	21.8	27.4	31.3
Slovenia	– 1.4	– 1.8	– 6.3	– 7.0	– 6.9	27.0	22.5	35.1	42.8	48.2
Slovakia	– 2.8	– 2.3	– 6.3	– 6.0	– 5.5	34.2	27.7	34.6	39.2	42.7

Source: European Commission, Autumn Economic Forecast 2009.

Short-term consolidation volume

An objective threshold value of the acceptable level of public debt can hardly be assessed[6]; thus consolidation requirements cannot be objectively defined either. The consolidation volume, finally, is subject to political judgment and depends on the goals determined.

The updated Austrian Stability Programme as of end-January 2010 complies with the European Commission's requirements to reduce the deficit until the year 2013 again below the upper limit of the European Stability and Growth Package of 3 percent of GDP, and outlines a consolidation path according to which the consolidation process is to start in the year 2011. The Maastricht deficit is to be reduced from 4.7 percent of GDP in 2010 to 4 percent in 2011, 3.3 percent in 2012, and 2.7 percent in 2013.

According to this requirement the cumulative consolidation volume for the years 2011 to 2013 will amount to well over € 10 billion (Table 4). The consolidation volume for each of the years therefore results from the difference between the deficit according to the consolidation path envisaged and the deficit in the reference scenario assumed without consolidation measures[7]. If the consolidation measures prove to have a lasting effect, i.e., they are effective not only in the implementation year but also in the subsequent years, then the additional consolidation volume neces-

[6] This applies at least for a country like Austria which is rather unlikely to go bankrupt. However, there are different theoretical and empirical concepts to measure the long-term capacity of the public financial conduct, which are also used in studies of the European Commission (e.g., *European Commission,* 2009). Here, the figures for Austria show a sustainability gap of 4.7 percent of GDP and are, therefore, below the EU average of 6.5 percent of GDP. The Domar formula accounts for the fact that, in a growing national economy it is not the absolute (growing) debt level that is of relevance, but the ratio between nominal growth rate and interest rate. If the nominal growth rate at a debt level given, without repayment, is above the interest rate, the debt rate will, ceteris paribus, decrease.

[7] The updated Stability Programme as of January 2010 quotes as follows (p. 22): "The national deficit will, in 2010, be 4.7 percent, as scheduled. ... In subsequent years, the national deficit will, if no consolidation measures are taken, remain on that level."

sary to maintain a compliance with the goals of the budget path will be smaller than the sum total of the consolidation volumes of the individual years. It will amount to € 2.1 billion in 2011, to well over € 2.2 billion in 2012. Given these prerequisites, no further consolidation measures will have to be taken in 2013, since the consolidation volume as necessary will already have been covered by the measures taken in the two years before. In the first year (2011), therefore, consolidation measures requiring € 2.1 billion will have to be taken, and further measures amounting to € 2.2 billion in 2012, in the third year (2013), by contrast, no additional measures will have to be taken. In order to reduce the deficit to 2.7 percent of GDP in 2013, one consolidation package each amounting to well over € 2 billion will have to be implemented in the years 2011, and 2012, respectively.

Table 4: Consolidation requirements for a reduction of the deficit rate to 2.7 percent of GDP to 2013

Updated Stability Programme, January 2010

	Maastricht balance		Consolidation volume[1]	Additional consolidation volume[2]
	Without consolidation measures	With consolidation measures		
	As a percentage of GDP			
2011	– 4.7	– 4.0	0.7	0.7
2012	– 4.7	– 3.3	1.4	0.7
2013	– 3.9	– 2.7	1.2	0.0
	Billion €			
2011	13.7	11.6	2.1	2.1
2012	14.2	9.9	4.3	2.2
2013	12.1	8.4	3.7	0.0
Ø 2011-2013	40.0	29.9	10.1	4.3

Source: Federal Ministry of Finance, WIFO. – [1] Difference between deficit with consolidation measures included and deficit excluding consolidation measures in the same year. – [2] Consolidation volume less consolidation volumes of the previous years.

Since the forecast for the revenue situation of the government has meanwhile been revised, and for the additional expenditure resolved upon recently (above all for the guaranteed minimum income), the budget consolidation requirements for 2011 are meanwhile estimated at € 2.8 billion by the Federal Ministry of Finance; as mentioned above, the consolidation package for 2011 is estimated accordingly.

Scenarios for the longer-term development of the debt rate

The consolidation scenario of the federal government refers, owing to the short life span of the official strategy documents, to the short-term period, thus using the current macro-economic and budgetary framework requirements for the three-year period 2011 to 2013. The short-term development of the debt rate until 2013 is forecast against that background.

By way of example, the debt rate for 2020, is, in the following, calculated by approximation of various scenarios of nominal GDP growth and the deficit rate (Table 5). Even if the average total Maastricht deficit is only 0.5 of GDP in the years 2010 to 2020, and the economy grows nominally by 3 percent p.a., it will take as long as to the end of the decade to reduce the debt rate to 60 percent of GDP. Assuming that GDP rises by 2 percent p.a. with an average budget deficit of 1 percent of GDP, the debt rate in 2020 will still be well over 71 percent of GDP. Conversely, given a balanced budget for the entire period, a nominal growth of GDP of 2.5 percent p.a. will suffice to reduce the debt rate below 60 percent of GDP until 2020.

On the average, the deficit for the years 2010 to 2013 amounts to about 3.7 percent of GDP according to the current budget path of the federal government. Nominal economic growth will, according to the current medium-term forecast of WIFO, reach well over 3 percent p.a. from 2010 to 2014.

These model calculations, on the one hand, underscore the importance of political efforts to stimulate economic growth as a prerequisite to restructure the government budget as quickly as possible. By rule of thumb, an economic growth rate of 1 percent improves the budget balance by 0.3 percent of GDP. An acceleration of the growth rate by 1 percentage point (about 4 percent instead of 3 percent) will consequently reduce the debt ratio by 5 to 6 percentage points by 2020. On the other hand, a reduction of current deficits as soon as possible constitutes an important factor to contain the debt to GDP ratio. Last but not least, the employment rate depends critically on economic growth: experience before the economic crisis shows that the number of full-time jobs increases only as from a real economic growth of 2 percent, and a real GDP growth of a minimum of 2.5 percent is required to reduce unemployment. By enhancing the labour intensity of growth and intelligent patterns to reduce working time (unpaid leave for further education and training, sabbaticals) these threshold values might be lowered by 0.5 percentage points.

Table 5: Public debt to GDP ratio in the year 2020 given alternative assumptions as to budget balances and economic growth

	Funding balance of the public budgets as a percentage of GDP				
	0.0	− 0.5	− 1.0	− 1.5	− 2.0
	Government debts as a percentage of GDP, nominal				
GDP growth in percent, nominal					
+4.0	51.1	55.2	59.3	63.4	67.5
+3.5	53.7	58.0	62.3	66.6	70.9
+3.0	56.3	60.7	65.1	69.5	73.9
+2.5	59.1	63.6	68.1	72.6	77.1
+2.0	62.1	66.7	71.3	75.8	80.4

Source: WIFO.

Macro-economic aspects of the consolidation of the budget

Potentially negative short-term effects

The necessity of a budget consolidation is largely undisputed. In the short term, consolidation efforts will not leave the labour market unaffected. In the longer term, the benefits of a regained economic and political leeway and the improved competitiveness of the economy will have positive effects also on the labour market. The present study shows, above all, such options that minimise or even remedy possible short-term effects, and, if possible, link short-term consolidation measures with long-term structural reforms. It proposes an "Impulsprogramm" prior to the upstart of the consolidation to be followed, in the consolidation phase, by more pronounced cuts of less efficient expenditure along with stepped-up growth-enhancing expenditure (permanent "Active Component"). Expenditure structures promoting growth and employment should also lessen unemployment. Radical structural reforms aimed at a sustainable economic performance cannot be initiated within the framework of a consolidation programme effective in the short term, but first steps to that end can be taken, especially within the framework of the "Impulsprogramm 2010" dealt with later in the present paper, as well as the Active Component accompanying the consolidation.

The consolidation of a structural budget deficit and the reduction of excessive public debts are always difficult, especially in periods of unsatisfactory employment development and under-employed capacities: public expenditure cuts and increased taxes invariably entail the risk of reduced aggregate demand. Consolidation measures, on the other hand, are necessary especially in such situations in which political attentism against the background of significantly rising deficits and public debt rates may easily cause a destabilisation of private households' and investors' consumption behaviour, and, consequently, even more shortage of demand. Also in the present crisis the relatively high and increasing savings rate reveals a certain destabilisation, and, a sustained high budget deficit as well as pronouncedly increasing public debt figures could worsen the expectations; the media and the financial market are beginning to take up the subject.

Fortunately, international studies show that it is possible to return to higher growth rates after a successful consolidation, at best even without medium-term losses in growth and employment. The favourable growth effect must, however, be developed by appropriately designing the consolidation strategy.

Growth facilitates consolidation: "Impulsprogramm 2010"

An important prerequisite for a sustainable consolidation strategy is a sufficiently strong economic growth. The latter not yet emerging, efforts should be taken in 2010 to increase, if possible, economic dynamics. Additional public spending with a high employment impact (qualification measures, childcare, long-term care) and positive external effects (research, buildings refurbishment), or incentives and specific regulations (standards), which in turn induce higher investment, especially in matters of environmental protection and thermal refurbishment, may well contribute to enhanced growth. An "Impulsprogramm" – if possible financed by way of budget reallocations and by not fully implemented measures of the economic stimulus packages, or elimination of tax exemptions – should be a good starting point for the consolidation in 2010. Contrary to the economic packages so far, however, measures with long-term structural effects (thermal refurbishment, qualification, research) should be preferred.

"Active Component" of the consolidation

The strategic goal of the consolidation is new budgetary leeway for the government. To that end, the existing short- and medium-term savings potentials must be exploited, and also longer-term adaptations in the course of budget law reforms and a comprehensive reform of federal (fiscal) relations are to be introduced, and the evasion of future spending by incentive-compatible mechanisms is to be safeguarded. If successful, new ground is regained for active interventions in economic and social spheres. More investment could be made in education, from childcare up to excellence programmes for universities, the R&D performance could be enhanced in order to improve competitiveness. Additionally, more funds could be allocated to health and long-term care; funds would be available for sophisticated and expensive innovations in environment and energy. The budget did not provide for these projects sufficiently even before the crisis, so they should be exempt from any cuts in the consolidation phase.

The WIFO study (*Aiginger et al.,* 2010) the present paper is based on recommends to arrive at a consolidation volume higher than the deficit requirements to be met, and spend the difference on growth-enhancing investment and measures creating jobs[8]. To arrive at a higher gross consolidation volume is an ambitious objective, yet it is growth-oriented and can be achieved by combining several measures. It is the responsibility of economic policy to combine these measures; the benefits and drawbacks of the individual options were analysed in the WIFO study.

Multiplier effects

For the expenditure side, propositions for savings concentrate on sectors that only slightly affect aggregate demand (multipliers); yet expenditure categories with a high multiplier and more pronounced growth effects are increased ("Impulsprogramm" and/or Active Component). Such a strategy should be successful, as the (positive) multiplier of the "Impulsprogramm" and Active Component, which focus on expenditure for thermal refurbishment, education, childcare, or long-term care, is higher than the (negative) multiplier of efficiency-enhancing expenditure savings such as the reduction of outlays for the civil service, cuts in subsidies, or closing down redundant hospitals and reducing the number of hospital beds, and their conversion into nursing and long-term care homes. Investments (infrastructure, emissions reduction, education, R&D, etc.) as proposed will enhance economic growth – if not in the first two years, so in the medium term – both as regards from the supply side and the demand side. Measures for the expenditure side were designed in such a way as to possibly not reduce private consumption and investment: this holds for the cutback of subsidies granted to enterprises as much as for moderate pension adjustments, the elimination of tax benefits, and tax increases (*Pitlik – Budimir – Gruber,* 2010). Deliberations with regard to the fact that financial balances (net savings) of

[8] This "Active Component" should be instrumental in the entire consolidation period. It is to be distinguished from the "Impulsprogramm", which stabilises the growth path and employment in the year prior to consolidation (2010). The fact that the consolidation volume aimed at by the federal government for 2011 is higher than that consolidation volume that is required to comply with the deficit goals, can be interpreted as the budget leeway created for an Active Component.

all economic sectors must add up to zero are also decisive for the issues mentioned above, and will be dealt with in the following paragraph.

Effects of demand

So as to minimise the short-term negative effects the following elements, amongst others, are important:

- The "Impulsprogramm 2010" is, by additional expenditure, and by the mobilisation of medium-term growth factors, to reinforce economic growth, and to restrain unemployment prior to the upstart of the consolidation phase (as from 2011).
- The effect of demand and the labour market intensity of public spending are to be increased, e.g., by waiving expenditure cuts that will benefit the lower income-bracket third, or by promoting labour-intensive thermal refurbishment.
- Mass taxes and social insurance contributions are not to be increased.

Deliberations regarding financial balances (net savings) adding up to zero

With part of aggregate demand curbed on the government side, one of the private demand components will need to increase, which goes to say that either enterprises will incur more debts, or private households save less, or the trade balance needs to improve. The effect on the savings rate or the investment on behalf of the enterprises is not very pronounced: if government demand drops by € 2 billion net owing to the consolidation, a savings volume less € 1 billion, a net debt increase by € ½ billion of the enterprises and a trade balance surplus of € ½ billion plus would suffice for compensation. The savings rate (private savings) rose, in the years 2002 to 2009, from 8.0 to 13 percent of GDP (in absolute figures by € 12 billion), private enterprises severely cut their investments (investments in assets in 2009 nominally € –4 billion), and the trade balance was again passive in the last years (2009 around € –5 billion) after a small surplus in 2007.

Lowering the savings rate

As other countries are likely to implement consolidation strategies at the same time, private demand components might possibly not (over)compensate any reductions in demand on behalf of the government. The following options in support of the consumption would dampen the savings rate:

- curtailment of savings incentives (as from a certain income bracket),
- introduction of a capital gains tax and/or increased real estate taxes and/or a re-introduction of the inheritance tax,
- elimination of the tax allowance for sole earners without children,
- partial replacement of social benefits by non-cash benefits,
- tax incentives for energy saving investments,
- avoidance of cuts of social expenditure for primarily low income brackets,
- avoidance of VAT increases,
- inclusion of consolidation measures into a credible, well-balanced overall concept so as to avoid any expectations of future tax burdens.

Readiness to incur debts on behalf of the enterprises

The propensity to invest will be further pushed by the possibility of accelerated depreciation (which, however, expires in 2010). Within the framework of the Active Component the benefits granted for investments into energy saving and environmental technologies could be improved. Subsidy cuts increasingly stimulate the enterprises to take out loans. By introducing a financial transaction tax, real investments should be encouraged to the detriment of financial investments. This measure and the impact of the "Impulsprogramm 2010" as well as a consolidation to be credibly announced should drive up the return rate of real investments, so that it equals off or surpasses real interest cost. Under these circumstances, the business sector would increase its net debt.

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Options for the Consolidation of Public Budgets in Austria

Starting Point and Prerequisites for Success – Summary

The programmes for financial market stabilisation and economic stimulus, which were implemented to mitigate the effects of the financial and economic crisis, as well as additional government expenditures in the wake of the crisis, have entailed substantial costs for government budgets. Furthermore, Austria observed a structural (i.e., non-cyclical) deficit already before the crisis. With increasing signs of an economic recovery the medium-term consolidation of government budgets is now on the agenda. The Austrian federal government aims at reducing the Maastricht deficit to 2.7 percent of GDP by 2013. In the medium term fiscal consolidation is necessary to regain room for manoeuvre for fiscal and economic policy and to avoid potentially undesired re-distributive effects of government debt. In the short term the consolidation measures can be expected to have some effect on the labour market. In the medium term the advantages of the regained budgetary leeway will have a positive impact on the labour market.

Against this background WIFO presents options for fiscal consolidation, which are based on a strategic approach. They do not merely aim at reducing government debt, but are also geared towards efficiency gains of government expenditure, towards supporting a reorientation of (economic and) political priorities and towards restructuring expenditures to enhance growth and employment.

One condition for a successful consolidation without dampening effects on growth and employment is the accompanying implementation of a permanent "activating element" via the promotion of growth-enhancing expenditures. The study recommends a consolidation volume above that required for meeting the defined objectives in order to use the extra consolidation gains for long-term investment and for measures to spur employment. The consolidation has to be designed in a way that raises the propensity to invest and lowers the savings ratio, so that total demand is not affected by the reduction of government demand. Therefore measures to support private consumption expenditure (e.g., reduction of subsidies for savings for higher incomes, avoiding a VAT increase) and business investment (e.g., the promotion of energy-saving investments and of environmental technologies) should be taken. Before the consolidation the government should implement an "Impulsprogramm" (stimulus package) for 2010, which spurs growth and employment via government expenditure, e.g., on thermal refurbishment, education and professional training, so that the starting position for the consolidation is improved.

If economic activity turns out weaker than forecast at the moment, something which cannot be ruled out, the timing and scope of consolidation will also have to be adjusted.

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