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Budget Proposal for 2005: Tax Reform Causes High Public Deficit

The 2004-05 tax reform and the after-effects of the stimulus packages will increase the total government's Maastricht-relevant deficit. The expansionary effect of the federal budget will be larger in 2005 than it has been in the preceding four-year period. Due to the divestment of public enterprises and institutions, federal financing expenditures will remain high. The shares of off-budget institutions in public investment, employment, and debt are increasing in the long run. Particularly due to the increase in family- and old-age-related transfers, federal transfer expenditures will gain in importance. The share of direct taxes in overall tax revenues will decrease further.

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In 2005, as in the previous three years, the total government's budget will not be balanced[1]. Two factors are primarily responsible for the failure to balance the budget since 2002. Firstly, the low growth rates in the past three years boosted public expenditures and dampened revenues: a consequence of the automatic stabilisers, but also of the various stimulus packages implemented by the government to stabilise the business cycle and to promote economic growth[2]. Secondly, the tax cuts provided for by the 2004-05 tax reform will, particularly from 2006 on, engender considerable losses in tax revenues, with further revenue losses resulting from the budgetary after-effects of the stimulus packages. Thus the years 2005 and 2006 will be characterised by sustained high budget deficits. A "zero deficit" is not expected before 2008.

Given the weakness of the economy since 2002, it was without doubt justified to tolerate revenue shortfalls as well as to increase government spending, even though these measures put a heavy burden on public budgets. A more restrictive fiscal policy would have aggravated the economic downturn. The tax cuts which will come into effect over the next two years (tax reform and stimulus packages) and which will have an expansionary effect on GDP[3] will fall in a period of economic recovery. The proposed budget for 2005 will be more expansionary than those of the preceding four-year period, when GDP growth was considerably lower. However, considering the weakness of domestic demand in autumn 2004 and the decreasing growth of world trade, such positive economic impulses may well be appropriate.

Improved overall economic conditions for fiscal policy

Compared to the past three years, the overall economic conditions for fiscal policy may gradually improve. In 2004, the beginning world-wide economic recovery was supporting Austria's economic upswing substantially; the improvement of the overall economic situation will rest to a larger degree on domestic demand in 2005. These positive prospects will (aside from the tax cuts) help to achieve the envisaged aims

[1] This article accounts for the changes introduced after the presentation of the first draft of the budget in October 2004; the data presented are taken from the final budget proposal adopted by the National Parliament in November 2004. Therefore some of the data presented here slightly deviate from those presented in *Schratzenstaller* (2004).

[2] For details concerning the first two stimulus packages, see *Schratzenstaller et al.* (2003).

[3] According to simulations carried out with the WIFO macro-model the tax reform will increase real GDP by 0.3 percent in 2005 and by 0.5 percent in 2006 (*Breuss – Kaniovski – Schratzenstaller,* 2004).

of fiscal policy and particularly to contain public deficits. Public budgets will profit from an easing pressure on expenditures which are highly dependent on the economic cycle, and the incipient pick-up will in principle exert a positive influence on public revenues.

Temporary deterioration of the deficit position

Federal revenues will fall by 0.5 percent to € 58.97 billion in 2005 (compared to the budget proposal for 2004); net of self-balancing items, they will decrease by 1.1 percent to € 58.05 billion. Expenditures of the general budget are estimated at € 64.4 billion (+2.8 percent); modified expenditures will amount to € 63.5 billion (+2.2 percent). Thus the trend of decreasing revenues[4] and subdued growth of expenditures at the federal level, which could be observed in the past years, will be continued in 2005. The administrative federal deficit will increase to € 5.45 billion (2.2 percent of GDP[5]).

Table 1: Federal budgets for 2002 to 2005

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €				Percentage changes from previous year		
General budget							
Expenditures	61,803	61,387	62,666	64,420	– 0.7	+ 2.1	+ 2.8
Revenues	59,413	57,890	59,236	58,969	– 2.6	+ 2.3	– 0.5
Administrative balance	– 2,390	– 3,498	– 3,430	– 5,451			
Adjustment budget							
Expenditures	34,697	51,623	50,993	49,104	+ 48.8	– 1.2	– 3.7
Revenues	37,087	55,121	54,423	54,555	+ 48.6	– 1.3	+ 0.2
Balance	+ 2,390	+ 3,498	+ 3,430	+ 5,451			

Source: Federal Ministry of Finance.

Table 2: Modified federal expenditures and revenues

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €			
General budget expenditures	61,803	61,387	62,666	64,420
– Self balancing items	– 1,874	– 929	– 519	– 921
Modified expenditures	59,929	60,458	62,147	63,499
General budget revenues	59,413	57,890	59,236	58,969
– Self balancing items	– 1,874	– 929	– 519	– 921
Modified revenues	57,539	56,960	58,717	58,048
Administrative balance	– 2,390	– 3,498	– 3,430	– 5,451

Source: Federal Ministry of Finance, WIFO calculations.

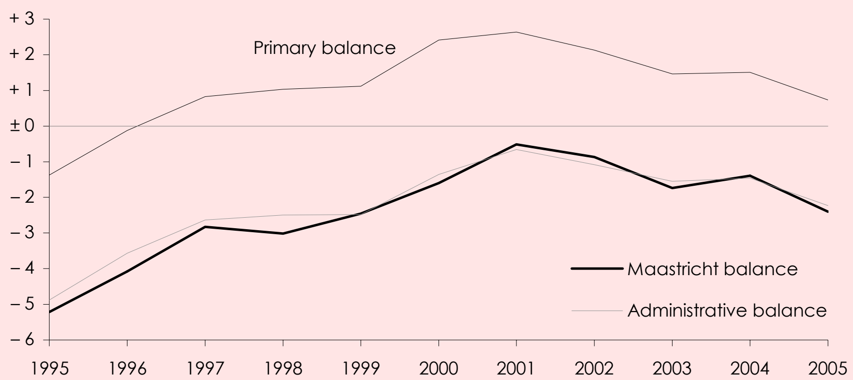
The total government's Maastricht deficit will increase also in 2005: the fourth year in which no "zero deficit" will be realised. In 2003, the Maastricht deficit was slightly below the consolidation path outlined in the Austrian Stability Programme; it amounted to 1.1 percent of GDP (€ 2.5 billion). For 2004 and 2005, however, it must be expected that the initially stated deficit targets are exceeded considerably.

[4] The year 2004 is an exception, due to the abolishment of the 13th VAT instalment in 2003: this measure created a one-time tax loss of about € 1.7 billion in 2003; revenues in 2004 therefore will be higher compared to 2003.

[5] The calculation of diverse ratios presented in this article will be based on the GDP data according to the WIFO Economic Outlook of December, 2004.

Figure 1: Federal budget balances

As a percentage of GDP



Source: Federal Ministry of Finance, WIFO calculations. 2004 and 2005 according to budget proposals.

In 2004, this was primarily owed to the advancement of several measures of the second phase of the tax reform[6], higher unemployment payments, lower profits distributed by the Oesterreichische Nationalbank, and a shortfall in tax revenues (particularly concerning VAT, corporate tax, and income tax). The shortfall in profit tax revenues was mainly caused by the third stimulus package adopted at the end of 2003, which, i.a., prolongs the tax premium for incremental investment[7] by another year. This tax premium was one element of the second stimulus package and was originally scheduled to be in effect until the end of 2003. According to Statistics Austria's updated budgetary notification[8], a Maastricht deficit of 1.3 percent of GDP (€ 3.05 billion) is estimated for all levels of government for 2004.

The high Maastricht deficit in 2005, which at 1.9 percent of GDP will markedly exceed the deficits incurred in the preceding years, is the consequence of considerable tax losses caused by the 2004-05 tax reform and the tax breaks granted by the stimulus packages. Moreover, the disappointing growth of VAT receipts in 2004 will carry over to 2005 via a basis effect. Based on the already finalised budget proposal for 2006[9], the total government's Maastricht deficit is estimated at 1.7 percent of GDP for 2006. According to the new Austrian Stability Programme published in November 2004, the Maastricht deficit is to be reduced to 0.8 percent of GDP in 2007. For 2008, a balanced budget is envisaged for the total government.

Missing the targets of the Austrian Stability Pact

Within the Austrian Stability Pact that applied for the period from 2001 to 2004, the federal level, the federal states and the municipalities had stipulated a yearly deficit of the federal government of 0.75 percent of GDP for the years 2002 to 2004 (2.05 percent for 2001). In 2004 (just as in the two preceding years) this deficit target was missed to a considerable extent: the federal Maastricht deficit is expected to reach 1.72 percent of GDP (Table 3)[10]. States and municipalities, which according to the Austrian Stability Pact are obliged to realise a budget surplus of 0.75 percent of GDP together, are (with the exception of 2003, when the set goal was more than fulfilled) increasingly departing from the target value. For 2004, the budget surplus of

[6] For details, see *Breuss – Kaniovski – Schratzenstaller* (2004).

[7] The tax premium for incremental investment will cause an estimated tax loss of about € 600 to 700 million in 2004 according to current projections.

[8] Budgetary notification to the European Commission from August, 2004, updated in October, 2004, because of the GDP revision (due to the inclusion of banking services measured indirectly – FISIM).

[9] The budget proposal for 2006 was adopted by the Council of Ministers together with the budget proposal for 2005 in October 2005, but for legal reasons cannot be adopted before March 2005, by the Austrian National Parliament; no details will be published beforehand.

[10] The deficit ratios presented in the following stem from the aforementioned budgetary notification of Statistics Austria (for the years 2001 to 2004) and from the recently updated Austrian Stability Programme of November 2004 (for 2005).

states and municipalities together is estimated at 0.45 percent of GDP. The aim to secure a balanced budget for the total government, which underlies the Austrian Stability Pact, is missed at the federal level, as it has been particularly affected by additional expenditures and revenue shortfalls brought about by the weak economic situation during the last years. However, it must be taken into account that several special rules apply for the assessment of the compliance of the federal levels to the Stability Pact. Moreover, as long as the final outturns for all governmentals are not available, a final assessment of the individual levels' performance is not possible.

Table 3: Maastricht balance of public budgets

	2001	2002	2003	2004	2005[1]
			As a percentage of GDP		
Level of state					
Total government	+ 0.25	− 0.21	− 1.10	− 1.31	− 1.9
Federal level	− 0.52	− 0.86	− 1.73	− 1.72	− 2.4
Federal states	+ 0.51	+ 0.42	+ 0.45	+ 0.34	+ 0.4
Municipalities (including Vienna)	+ 0.26	+ 0.25	+ 0.18	+ 0.11	+ 0.2
States and municipalities	+ 0.77	+ 0.67	+ 0.63	+ 0.45	+ 0.6
Social security institutions	0.0	− 0.01	0.0	− 0.04	− 0.1

Source: Statistics Austria; Federal Ministry of Finance. + . . . surplus, − . . . deficit. – [1] According to Austrian Stability Programme for 2005 to 2008.

The new revenue sharing agreement and the new Austrian Stability Pact for the period 2005 to 2008, which were finalised in late 2004 (*Schratzenstaller,* 2005), aim at securing the achievement of the deficit target of 1.9 percent of GDP for the total government in 2005: the tobacco tax as well as the earnings limit for chargeable contributions and health insurance contributions will be raised, certain health insurance benefits will be cut, and fees for hospital stays and prescriptions will be increased. States and municipalities will receive additional payments within the revenue sharing system. Thus the federal Maastricht deficit will increase to 2.4 percent of GDP in 2005, while the overall budget surplus at the level states and municipalities will be slightly higher (0.6 percent of GDP) than assumed when presenting the budget proposal for 2005 in the middle of October.

When assessing the deficit projections for 2005, certain risks must be considered, which may arise from the future development of the exchange rate and the crude oil price. A prolonged and sustained rise of the crude oil price could slightly dampen the economic upswing expected for 2005. The achievement of the deficit target will also depend on the actual development of tax revenues. Concerning the latter, some imponderability does exist: particularly regarding the extent of the budgetary effects of the corporate tax reform in 2005 and a possible further decoupling of VAT revenues from nominal consumption.

Austria's deficit position in a European comparison

In its recent economic outlook (autumn 2004), the European Commission expects that compared to the European average Austria will come off well with regard to its deficit position (Table 4). However, whilst public finances have been deteriorating all over Europe since 2002, Austria's deficit position will worsen to a considerably higher extent. While in the Euro zone the Maastricht deficit will rise by 0.1 percentage point on average (from 2.4 percent of GDP in 2002 to 2.5 percent of GDP in 2005), the Austrian deficit will surge by 1.8 percentage point in this period.

Austrian public debt, however, is developing against the European trend: while in the Euro zone the debt ratio is estimated to go up from 69.4 percent of GDP in 2002 to 71.1 percent of GDP in 2005, Austria can expect a decrease from 65.7 percent of GDP to 63.9 percent of GDP in this period. Thus the span between Austria's debt ratio and the average one for the Euro zone will increase further.

The government holds on to its goal of reducing the size of the public sector, which also in 2005 will be mirrored by still decreasing revenue and expenditure ratios. Modified federal revenues (net of self-financing items) will decrease markedly (to 23.7 percent of GDP), mainly due to the 2004-05 tax reform. The decrease in the revenue ratio is caused by a reduction of absolute total revenues. Due to tax reform and stimulus packages, the net tax ratio[11] at the federal level will decrease considerably by 2.9 percent to 15.3 percent of GDP, but the drop of tax-like revenues, which will experience a reduction by 2.7 to 3.8 percent of GDP, is also remarkable. These reductions will only partly be compensated by an increase in other revenues: they will rise by 6.9 percent to 4.6 percent of GDP.

Table 4: Maastricht balance and debt position of EU countries

	Maastricht balance		Debt position	
	2002	2005 Forecast	2002	2005 Forecast
	As a percentage of GDP			
Belgium	+ 0.1	– 0.3	105.4	94.4
Denmark	+ 0.7	+ 1.5	48.8	40.3
Germany	– 3.7	– 3.4	60.9	67.2
Greece	– 3.7	– 3.6	112.5	111.9
Spain	– 0.1	– 0.1	54.4	45.5
France	– 3.2	– 3.0	58.8	65.5
Ireland	– 0.2	– 0.6	32.7	30.7
Italy	– 2.3	– 3.0	107.9	104.6
Luxembourg	+ 2.8	– 1.6	5.7	4.8
The Netherlands	– 1.9	– 2.4	52.6	58.0
Austria	– 0.2	– 2.0	65.7	63.9
Portugal	– 2.7	– 3.7	58.4	62.0
Finland	+ 4.3	+ 2.1	42.6	43.4
Sweden	± 0.0	+ 0.6	52.6	50.6
UK	– 1.7	– 2.6	38.3	40.9
EU 15	– 2.1	– 2.4	62.7	64.5
Euro area	– 2.4	– 2.5	69.4	71.1
Czech Republic	– 6.8	– 4.7	28.8	39.4
Estonia	+ 1.4	+ 0.2	5.3	4.4
Cyprus	– 4.6	– 3.0	67.4	72.4
Latvia	– 2.7	– 2.8	14.1	15.4
Lithuania	– 1.5	– 2.5	22.4	21.7
Hungary	– 9.2	– 5.2	57.2	59.5
Malta	– 5.8	– 4.0	62.3	73.7
Poland	– 3.6	– 4.1	41.1	49.8
Slovenia	– 2.4	– 2.2	29.5	30.8
Slovakia	– 5.7	– 4.0	43.3	45.2
EU 25	– 2.3	– 2.4	61.6	63.5

Source: European Commission, Economic Forecast, Autumn 2004.

The federal expenditure ratio will go down from 26.5 percent of GDP according to the 2004 budget proposal to 25.9 percent of GDP in 2005, because expenditures are still increasing at a slower pace than nominal GDP. The ratio of expenditures for the provision of public services is decreasing further und will reach 6.4 percent of GDP in 2005; these expenditures will – just as within the 2004 budget proposal – also fall in absolute terms. The relation of financing expenditures to GDP (9.4 percent) will also slightly decrease compared with 2002. In 2005, these expenditures will increase against 2004. The increase budgeted for 2004 dates back to the spin-off of the universities in 2004. The ratio of transfer expenditures will remain constant at 10.2 percent of GDP in 2005 and will – after temporary increases – equal the level of 2001.

In the period from 2002 to 2005, the development of the federal administrative deficit is determined, to various degrees, by the growth of expenditure and revenue ratios in each single year. In 2002 and 2003 the administrative deficit increased because the revenue ratio was reduced faster than the expenditure ratio. According to the 2004 budget proposal, expenditure and revenue ratios drop to an identical degree so that the administrative deficit as a percentage of GDP remains constant. In 2005, however, a marked increase of the administrative deficit as a percentage of GDP must be expected as the reduction of the revenue ratio exceeds that of the expenditure ratio.

[11] Gross tax revenues minus transfers to federal funds, federal states, municipalities, and EU.

The Federal Budget for 2003 to 2005 – an Overview

Outturn for 2003

The outturn of the general budget shows revenues of € 57.89 billion and expenditures of € 61.39 billion. The administrative deficit amounted to € 3.5 billion (1.5 percent of GDP; 1.1 percent of GDP in 2002 and 0.7 percent of GDP in 2001). Revenues were higher than estimated by € 0.48 billion, whereas actual expenditures only slightly exceeded the budgeted ones. Thus the actual federal administrative deficit was under budget by € 0.44 billion due to higher revenues (mainly because of the withdrawal of reserves). The federal Maastricht deficit reached 1.73 percent of GDP. The adjustment budget contains revenues of € 55.12 billion and expenditures of € 51.62 billion.

Budget for 2004[1]

The general budget for 2004 projects revenues of € 59.24 billion and expenditures of € 62.67 billion. Compared to the outturn for 2003, this implies an increase in expenditures of 2.1 percent and an increase in revenues of 2.3 percent, the latter mainly resulting from the abolishment of the 13th VAT instalment in 2003. It must be expected that federal revenues fall short markedly of the budget estimates, as a result of the weak development of tax revenues, which mainly affect the federal level, and of lower distributed profits from the Oesterreichische Nationalbank. The expenditure side is, on the one hand, alleviated by lower payments to the EU budget and lower interest payments; on the other hand, however, unemployment payments and old-age pension payments for civil servants overrun the budget estimates. The federal Maastricht deficit therefore won't be depressed to 1.4 percent of GDP, as initially expected, but according to the preliminary outturn for 2004 remains at 1.7 percent of GDP. The federal administrative deficit (projected at € 3.43 billion or 1.5 percent of GDP) reaches 1.9 percent of GDP. The adjustment budget provides for expenditures of € 50.99 billion and revenues of € 54.42 billion.

Budget proposal for 2005

According to the budget proposal for 2005, expenditures within the general budget will amount to € 64.4 billion, revenues to € 58.97 billion. In comparison with the budget estimates for 2004, this means a revenue reduction of 0.5 percent and an expenditure increase of 2.8 percent. The revenue side will primarily be affected by the tax cuts provided for by the tax reform 2004-05 and the stimulus packages. The federal administrative deficit will rise to € 5.45 billion (2.2 percent of GDP). The federal Maastricht deficit will surge further in 2005; it will reach 2.4 percent of GDP. The adjustment budget shows revenues of € 54.56 billion and expenditures of € 49.1 billion.

[1] The budget for 2004 was already adopted in June 2003 by the Austrian National Parliament; for details see *Lehner – Schratzenstaller* (2003).

Gender Budgeting

"Gender Budgeting" concentrates on the question how expenditures and revenues are allocated to men and women, and how budget policy affects the distribution of resources between men and women in the short and in the long run. It analyses how budget policy influences gender roles as well as the distribution of paid and unpaid work among men and women.

For the first time, the 2005 budget proposal includes a gender-sensitive analysis of one selected budget item per ministry. The analysis can refer to various areas, like subsidies or functionally defined expenditures (e.g., health and education), or to sub-areas, as expenditures for new projects or expenditures of certain departments and positions (*Federal Ministry of Finance,* 2004A). Each ministry is requested to present the budget item which is to be analysed as well as (if available) first results of the gender-sensitive analysis, as part of the specific explanations each ministry has to provide within the supplement to the budget proposal (*Federal Ministry of Finance,* 2004C).

This initiative is a first important starting-point for the integration of gender aspects into the budget process. Further, comprehensive and coordinated analyses on the expenditure as well as on the revenue side of the federal budget should follow. In particular, the next steps should be the extension of the gender budget analysis to all ministries and gender-relevant budget items and the combination of individual results to a comprehensive analysis of the total federal budget, so that direct and indirect effects of public expenditures and revenues can be assessed as a whole.

The analysis itself then should result in the formulation of budgetary measures which can help to eliminate existing gender-specific disparities (e.g., regarding the gender-specific distribution of paid and unpaid employment or of incomes). In the long run, in a federal state like Austria the lower governmental levels (states and municipalities) as well as the social security institutions are also to be included, as a prerequisite for the identification of the gender-specific effects of the total government's budget and for the development of coordinated measures to diminish gender-specific inequalities.

The GDP-relevant budget balance (the administrative balance adjusted by capital transactions and net allocation to reserves) is decisive for the assessment of the effect of the federal budget on the business cycle. In 2003 the GDP-relevant balance amounted to € 4.67 billion. Thus, it was under budget by € 0.44 billion due to the unexpectedly positive development of revenues, but still considerably exceeded that of 2002 (mainly because of the abolishment of the 13th VAT instalment). The 2004 budget proposal estimated a reduction of the GDP-relevant balance to € 3.69 billion; currently the shortfalls in tax receipts suggest a higher GDP-relevant balance and therefore a stronger expansionary effect. The tax losses incurred by the 2004-05 tax reform will raise the GDP-relevant balance considerably in 2005 (to € 5.89 billion). Overall, the federal budget will have a slightly expansionary effect, even if the expenditure increase will remain markedly below nominal GDP-growth. In contrast to the preceding years, the allocation of reserves to improve the administrative balance will hardly play any role in 2005.

Table 5: Components of the federal budget balance

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €			
Balance of current transactions	+ 3,707	+ 622	+ 2,409	+ 284
Investments and property acquisitions	+ 401	+ 242	– 117	– 155
Capital transfers (net)	– 5,838	– 5,531	– 5,987	– 6,018
GDP-relevant balance	– 1,730	– 4,667	– 3,695	– 5,889
Balance of contributions to capital formation	– 77	– 46	– 40	+ 270
Allocation to reserves	– 583	+ 1,216	+ 305	+ 168
Administrative balance	– 2,390	– 3,498	– 3,430	– 5,451
Interest (excluding currency swaps)	+ 7,099	+ 6,807	+ 6,960	+ 7,232
Primary balance	+ 4,709	+ 3,310	+ 3,530	+ 1,782

Source: Federal Ministry of Finance, WIFO calculations

Development of level and structure of expenditures

Federal expenditures for the provision of public services will further lose in importance (decrease of 2.2 percent compared to 2004). Financing expenditures, which according to the outturn for 2003 decreased rather strongly in comparison to the preceding year, will rise again in 2005 (+2 percent), after surging in 2004 due to the spin-off of the universities. Transfer expenditures, which in 2004 were budgeted below the 2003 level (–0.5 percent), will be on the rise again in 2005. At € 24.94 billion they will reach almost 40 percent of overall expenditures.

Table 6: Economic breakdown of federal expenditures

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €				Percentage changes from previous year		
Provision of public services	16,095	16,236	15,891	15,544	+ 0.9	– 2.1	– 2.2
Transfers	22,849	24,031	23,900	24,937	+ 5.2	– 0.5	+ 4.3
Financing	20,985	20,191	22,356	23,018	– 3.8	+ 10.7	+ 3.0
Total	59,929	60,458	62,147	63,499	+ 0.9	+ 2.8	+ 2.2
	Percentage shares						
Provision of public services	26.9	26.9	25.6	24.5			
Transfers	38.1	39.7	38.5	39.3			
Financing	35.0	33.4	36.0	36.2			
Total	100.0	100.0	100.0	100.0			

Source: Federal Ministry of Finance, WIFO calculations.

Transfer expenditures increasing in importance again

In the 2004 budget proposal, some indications could be detected that the trend of continuously increasing shares of transfer expenditures in overall expenditures would eventually come to a halt. According to the budget proposal for 2005, however, the trend of growing transfer expenditures obviously could not be reversed permanently, with transfer expenditures scheduled to grow at an above-average rate (+4.3 percent against the budget estimate for 2004). In 2003, the actual growth rate of transfer expenditures (+5.2 percent) was higher than budgeted (+4.2 percent), a consequence mainly of higher old-age expenditures, but also of higher unemployment expenditures.

In 2005, the growth rate of family-related transfers will be slightly above the average (+4.9 percent); compared to the average of the three preceding years (+7.5 percent), however, this signifies a slowdown. In 2003, this expenditure group increased by 11 percent and therefore exceeded budget estimates, which mainly dates back to increasing expenditures for family allowances (raised in 2003) and child-care benefits (introduced in 2002 to replace parental leave benefits). The share of family-related transfers in total transfer payments will increase also in 2005, to 17.5 percent (€ 4,373 million). In all, the dominance of monetary family benefits compared to real family-related transfers will increase further.

The growth of family-related transfers is caused by several factors. Payments to the Family Burden Equalisation Fund will rise, as the expansion of family-related transfers will increase the deficit of the Family Burden Equalisation Fund to € 425 million in 2005. As the financial means of the Family Allowance Reserve Fund are exhausted, this deficit will necessitate advance payments from the federal budget. Already in 2003 the deficit of the Family Burden Equalisation Fund at € 295 million considerably exceeded the budget (€ 230 million) and had to be financed by additional federal payments. Family allowances and child care benefits (raised for multiple births in 2004 and full replacement of the parental leave benefit from 2005 on) will cause additional expenditures. Finally, transfers to the old-age pension system to cover pension insurance contributions for parents on parental leave will also raise family-related transfers[12].

Table 7: Federal transfer expenditures

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposals	2005 Budget proposals
	Million €				Percentage changes from previous year		
Old-age expenditures	13,689	14,281	14,021	14,640	+ 4.3	− 1.8	+ 4.4
Pensions for federal civil servants	2,750	2,879	2,916	3,248	+ 4.7	+ 1.3	+11.4
Pensions for state teachers	758	850	797	926	+12.2	− 6.3	+16.2
Pensions for federal postal employees	972	1,059	1,098	1,156	+ 9.0	+ 3.6	+ 5.3
Pensions for federal railway employees	1,746	1,767	1,777	1,820	+ 1.2	+ 0.6	+ 2.4
Contributions to pension insurance institutions[1]	7,463	7,726	7,433	7,490	+ 3.5	− 3.8	+ 0.8
Family-related expenditures	3,684	4,088	4,168	4,373	+11.0	+ 1.9	+ 4.9
Family allowances[2]	2,826	2,973	2,978	3,014	+ 5.2	+ 0.2	+ 1.2
Parental-leave benefits, child-care benefits	858	1,115	1,190	1,358	+30.0	+ 6.7	+14.2
Unemployment benefits	2,135	2,248	2,230	2,426	+ 5.3	− 0.8	+ 8.8
Long-term care benefits	1,294	1,333	1,350	1,391	+ 3.0	+ 1.3	+ 3.0
Others	2,047	2,081	2,131	2,108	+ 1.7	+ 2.4	− 1.1
Total	22,849	24,031	23,900	24,937	+ 5.2	− 0.5	+ 4.3

Source: Federal Ministry of Finance, WIFO calculations. – [1] Including equalisation supplements and transfers to the Compensation Fund of the pension insurance institutions. – [2] Including child-birth benefits and school commuting grants.

Federal expenditures for old-age pensions – which at a share of almost 59 percent will be the largest expenditure item within federal transfer payments – will also show a rather high growth rate in 2005: they are expected to rise by 4.4 percent, compared to a yearly average of 2.6 percent in the three preceding years. Strongly increasing federal pension expenditures are partly responsible for this development; furthermore, federal payments to the pension insurance system will again slightly rise (+0.8 percent), a result of the rise in pension benefits assumed for 2005. The interim provisions of the 2003 pension reform, which came into effect in 2004, induced extensive early retirement. Therefore old-age pension expenditures for federal civil servants (+11.4 percent) and compensation payments for pensions paid to state

[12] From 2005 on, there will be no fixed ceiling for the contributions to the old-age pension system for parents on parental leave, but they will amount to 22.8 percent of the specified income support threshold (Ausgleichszulagenrichtsatz).

teachers (+16.2 percent) will rise strongly; old-age pension expenditures for federal postal employees (+5.3 percent) are also on the increase.

Table 8: Structure of federal transfer expenditures

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Percentage shares			
Old-age expenditures	59.9	59.4	58.7	58.7
Family-related expenditures	16.1	17.0	17.4	17.5
Unemployment expenditures	9.3	9.4	9.3	9.7
Long-term care expenditures	5.7	5.5	5.6	5.6
Others	9.0	8.7	8.9	8.5
Total	100.0	100.0	100.0	100.0

Source: Federal Ministry of Finance, WIFO calculations.

The marked increase in federal pension expenditures for civil servants, state teachers, and federal postal and railway employees will only partly be compensated by increasing pension-related federal revenues[13]. Accordingly, net expenditure on pensions, which receded (against the trend of the preceding years) in 2004, will increase again in 2005 (+3.9 percent).

The share of federal old-age pension expenditures in overall transfer expenditures was on the decline according to the 2004 budget proposal; it will remain constant in 2005.

Table 9: Federal pension expenditures, net

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €				Percentage changes from previous year		
Pensions for federal civil servants	2,750	2,879	2,916	3,248	+ 4.7	+ 1.3	+ 11.4
Compensation for pensions paid to state teachers	758	850	797	926	+ 12.2	– 6.3	+ 16.2
Pensions for federal postal employees	972	1,059	1,098	1,156	+ 9.0	+ 3.6	+ 5.3
Pensions for federal railway employees	1,746	1,767	1,777	1,820	+ 1.2	+ 0.6	+ 2.4
Contributions to pension insurance	4,955	5,822	5,875	5,964	+ 17.5	+ 0.9	+ 1.5
Equalisation supplements	926	1,107	762	822	+ 19.5	– 31.2	+ 8.0
Transfers to the Compensation Fund of the pension insurance institutions	1,582	797	797	704	– 49.6	+ 0.0	– 11.7
Total expenditures	13,689	14,281	14,021	14,640	+ 4.3	– 1.8	+ 4.4
Pension contributions by federal civil servants	560	561	551	564	+ 0.3	– 1.9	+ 2.5
Contributions as per Section 13 PG	75	79	80	125	+ 5.3	+ 2.4	+ 55.4
Contributions by state teachers	21	22	22	33	+ 3.6	+ 1.2	+ 52.2
Pension contributions, postal service	245	228	193	199	– 6.7	– 15.4	+ 2.8
Pension contributions, Austrian Railways	445	445	426	384	– 0.0	– 4.3	– 9.8
Pension security contributions, Austrian Railways	61	64	66	66	+ 5.5	+ 2.8	± 0.0
Other pension-related revenues	58	52	151	250	– 10.5	+190.2	+ 65.6
Total revenues	1,464	1,451	1,489	1,621	– 0.9	+ 2.6	+ 8.9
Pension expenditures, net	12,225	12,830	12,532	13,018	+ 5.0	– 2.3	+ 3.9

Source: Federal Ministry of Finance, WIFO calculations.

Unemployment expenditures are expected to grow at the fastest pace in 2005 (+8.8 percent), therefore their share in total transfer expenditures will increase to 9.7 percent. For 2005, they are budgeted at € 2,426 million. The least dynamic item in this expenditure category are long-term care benefits. They will grow at 3 percent in 2005 (to € 1,391 million) due to the valorisation of the long-term care benefit by 2 percent and the growing number of recipients. Their share in overall federal transfer expenditures will remain constant at 5.6 percent.

[13] Old-age pension contributions by federal civil servants, state teachers, federal postal and railway employees, etc.

Increase in financing expenditures

The share of financing expenditures in total federal expenditures decreased until 2003, but they have been on the rise again since 2004, due to the spin-off of the universities. The 2005 budget proposal envisages an increase in total financing expenditures by 3 percent (to € 23.02 billion), which is primarily caused by strongly rising interest payments on federal public debt (+7.2 percent). After having declined continuously during the past years, interest expenditures rose again in 2004 already and will reach (excluding swaps) € 7.23 billion in 2005. This is mainly due to changes in variable interest rates and price fluctuations within foreign-currency financing, as well as to the strong increase in public debt in 2004 because of the remission of debt for Austrian Railways and SCHIG.

Table 10: Federal financing expenditures

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €				Percentage changes from previous year		
Interest for federal public debt[1]	8,362	8,024	8,111	8,696	– 4.0	+ 1.1	+ 7.2
Transfers to public entities	6,921	7,373	9,157	9,478	+ 6.5	+ 24.2	+ 3.5
Lump-sum transfer to universities			1,703	1,725			+ 1.3
Others	6,921	7,373	7,455	7,753	+ 6.5	+ 1.1	+ 4.0
Transfers to enterprises	3,095	3,016	3,930	3,812	– 2.5	+ 30.3	– 3.0
Expenses for monetary transfers, exchange losses and refunds	164	299	233	129	+ 82.1	– 22.0	– 44.8
Loans granted, acquisitions of shares	125	135	119	132	+ 8.2	– 12.3	+ 11.1
Allocation to reserves	1,651	621	0	0	– 62.4	–100.0	± 0.0
Others	666	722	804	771	+ 8.3	+ 11.4	– 4.0
Total	20,985	20,191	22,354	23,018	– 3.8	+ 10.7	+ 3.0

Source: Federal Ministry of Finance, WIFO calculations. – [1] Including currency swaps.

Transfers to public entities[14] will increase at a rate above average (+3.5 percent), which is partly due to the additional federal transfers to the subnational levels stipulated in the new revenue sharing agreement. Transfers to enterprises will decrease, mainly because of falling contributions to international debt relief. After permanent increases in the preceding years – the consequence of continuously sourcing out federal public entities which is reflected in falling expenditures for the provision of public services – the share of federal transfers to public entities and enterprises in total financing expenditures will slightly drop in 2005, but will remain at a rather high level of almost 58 percent (€ 13.29 billion).

Expenditures for the provision of public services declining further

Following the trend that could be observed during the last years, expenditures for the provision of public services are further losing in importance. In 2003, these expenditures increased at a considerably lower pace (+0.9 percent) than budgeted (+2.6 percent), mainly because of lower operating expenses and staff costs, but also due to lower investment.

According to the 2005 budget proposal, staff costs for federal employees are the only item expected to increase slightly (+1.3 percent), after a marked decline budgeted for 2004 (investment outlays will also increase, but have become negligible). The growth in staff costs is likely to be limited by further staff reductions (not the least due to spin-offs) and by low wage increases.

Altogether expenditures for the provision of public services will be reduced by 2.2 percent in 2005, and will amount to € 15.54 billion, i.e., almost one fourth of overall expenditures. Their declining weight primarily mirrors the extensive outsourcing of tasks from the federal budget during the past ten-year period. This outsourcing strategy not only limits the options of the state to actively intervene in the respective areas (for example, universities), as the state only acts as a financier. It also increases the complexity of financial linkages between the federal level and off-budget public entities, so that the federal budget itself and overall public activities become less and less transparent. It is getting increasingly difficult to assess and to control the ex-

[14] States, municipalities and local authorities associations; social security funds; outsourced institutions.

tent and the structure of "public" investment spending and of employment or the contribution of the off-budget public entities to overall public debt.

Table 11: Federal expenditures for the provision of public services

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €				Percentage changes from previous year		
Staff costs, federal employees	6,935	7,057	6,754	6,845	+ 1.8	− 4.3	+ 1.3
Staff costs, reimbursement for state teachers	2,810	2,811	2,808	2,743	+ 0.0	− 0.1	− 2.3
Staff costs, postal service employees	1,016	909	1,010	838	− 10.6	+ 11.1	− 17.0
Operating expenses	4,919	5,204	5,147	4,935	+ 5.8	− 1.1	− 4.1
Investments	377	227	163	174	− 39.7	− 28.2	+ 6.4
Acquisition of properties and titles which can be capitalised	38	28	10	9	− 25.5	− 65.1	− 4.5
Total	16,095	16,236	15,891	15,544	+ 0.9	− 2.1	− 2.2

Source: Federal Ministry of Finance, WIFO calculations.

Quantitative Importance of Off-Budget Public Entities

Different indicators can be used to capture the extent and development of the weight of off-budget public entities. Here the quantitative weight of off-budget public entities is assessed using their shares in overall investment, employment, and debt of the state (Table 12).

The shift of public investment activities from the budgets of the individual levels of government (federal level, states, and municipalities) to off-budget public entities (ASFINAG, BIG, etc., at the federal level; hospitals, etc., at the state level, and hospitals, etc., at the municipal level) is particularly striking. The share of off-budget public entities in overall investment of the state has increased from only 1.6 percent in 1995 to almost one half in 2004.

To determine total state debt, the Maastricht-relevant debt of the federal level, the states, the municipalities, and the social security institutions as well as the debt of off-budget public entities (public entities at the federal level: ASFINAG, Austro Control, BIG, Museumsquartier, ÖBB, ÖIAG, ÖSAG, PTBG, SCHIG; hospitals of the states; market enterprises at the municipal level: local authorities associations, infrastructure enterprises, Wiener Wohnen) are added up (excluding debt finance on the federal level and the state level for third parties already included in the Maastricht-relevant debt). The share of off-budget public entities in overall debt of the state decreased between 1998 and 2000, but rose again to 18.9 percent in 2002.

Data on the number of employees of off-budget public entities are incomplete. For the municipalities excluding Vienna only data for all employees (including spin-offs) are available. For the states, employment data for outsourced entities are incomplete; only data on employment effects of the outsourcing of state hospitals are available, but not on further (less labour-intensive) spin-offs, e.g., real estate companies of the states or administrative activities (promotion of residential building, IT services, tourism marketing). Therefore the share of off-budget public entities in overall public employment is underestimated. Moreover, statistical-methodical differences and differences in the tasks to be fulfilled at the governmental levels render a direct comparison (and therefore also the adding-up of employment data at all levels of the state as in Table 12) problematic. Nevertheless, the calculated shares give a first impression of the rising weight of off-budget public entities in total public employment: the share of public employees active in outsourced entities of the federal level, the states, and Vienna increased from 0.1 percent in 1997 to 17.3 percent in 2002.

Table 12: Indicators for the weight of off-budget public entities

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
					Million €					
Investment										
Off-budget entities[1]	87	117	1,617	1,749	1,849	1,834	2,414	2,403	2,732	2,614
Public budgets[2]	5,267	5,074	3,607	3,531	3,420	3,126	2,469	2,820	2,799	2,750
Total	5,354	5,191	5,224	5,280	5,269	4,960	4,883	5,223	5,531	5,364
Percentage share of off-budget entities	1.6	2.3	31.0	33.1	35.1	37.0	49.4	46.0	49.4	48.7
					Billion €					
Debt position										
Off-budget entities[3]	.	.	.	27.3	28.6	26.3	29.2	31.1	.	.
Total government[2]	.	.	.	123.6	133.0	138.4	142.6	145.3	.	.
Total[4]	.	.	.	148.7	156.2	156.9	162.4	164.6		
Percentage share of off-budget entities	.	.	.	18.4	18.3	16.8	18.0	18.9	.	.
					Persons					
Employment										
Off-budget entities[5]	.	.	657	657	1,336	77,588	78,674	81,377	.	.
Public budgets	.	.	469,555	470,463	469,749	400,533	395,350	389,844	.	.
Total	.	.	470,212	471,120	471,085	478,121	474,024	471,221	.	.
Percentage share of off-budget institutions	.	.	0.1	0.1	0.3	16.2	16.6	17.3	.	.

Source: Statistics Austria, Federal Ministry of Finance; *Frisch – Hauth – Grossmann* (2004), *Staatsschuldenausschuss* (2004), WIFO calculations. – [1] Federal level: ASFINAG, SCHIG, other off-budget entities; states: hospitals and others; municipalities: hospitals and others. – [2] Federal level, states, municipalities, and social security institutions. – [3] Enterprises of public budgets (federal enterprises: ASFINAG, Austro Control, BIG, MUQUA, ÖBB, ÖIAG, ÖSAG, PTBG, SCHIG, incl. federal financing for other public entities – Rechtsträgerfinanzierung; states: hospitals, incl. state financing of public undertakings; market enterprises of municipalities: local authorities associations, infrastructure enterprises, Wiener Wohnen). – [4] The total debt position of the state is lower than the sum of the debt positions of the off-budget institutions and the total government, as both include financing for public undertakings and for other public entities, respectively. – [5] Excluding employees in off-budget entities and market enterprises of municipalities, respectively.

Focal points within public expenditures

The budget for 2005 is a further step towards a long-term reduction of the public sector. Moreover, several focal points within the expenditure structure were announced that are expected to promote long-term economic growth, though the focal points announced are not clearly delineated in all the areas in question (research, education and science, infrastructure).

R&D-related federal expenditures will increase by 1.7 percent (€ 25 million) to € 1,523 million (*Federal Ministry of Finance*, 2004B). Thus the direct contribution of the federal budget to the increase of the research ratio[15] will be modest in 2005. In face of the current shares of the federal budget in total gross domestic research expenditures, the budget for 2006 will have to provide for considerably higher additional financial means if the envisaged research ratio of 2.5 percent of GDP is to be achieved. At the same time this aim requires also a marked increase of the research expenditures of the private sector. These are to be stimulated by the gradual extension of tax breaks[16] for R&D expenditures of private firms effected during past years; the resulting tax losses of € 100 million per year in the period 2004 to 2006 do not affect the expenditure, but the revenue side of the federal budget.

Another focal point was announced for education and science. The 2004 university reform, which includes the outsourcing of the universities, causes shifts within the education and science budget, which considerably complicate long-term comparisons of the universities' budgets. Thus there are also breaks in the statistics on the development of education and science expenditures, which render a direct comparison of this ministry's expenditures for 2005 with those of the preceding years problematic. For the lump sum transfer to the universities, an increase of 1.3 percent (from € 1,703 to 1,725 million) is budgeted for 2005[17]. Total expenditures for the uni-

[15] The research ratio (as relation of total public and private gross domestic research expenditures to GDP) will increase to 2.26 percent of GDP in 2004 according to Statistics Austria; the Lisbon Strategy as well as the Austrian government envisage its increase to 2.5 percent in GDP until 2006 and to 3 percent of GDP until 2010.

[16] The increase of the research tax allowance and tax premium causes tax losses of € 100 million per year from 2004 on (*Federal Ministry of Finance*, 2004A). For details concerning public support of research and development in Austria see *Federal Ministry of Education, Science, and Culture – Federal Ministry for Transport, Innovation and Technology – Federal Ministry for Economics and Labour* (2004).

[17] The university law fixes a lump sum transfer of € 1,661 million per year for the period from 2004 to 2006; in addition, there are certain increases (e.g., for civil servants and other staff). Study fees, which go directly to

versities (including the provision of rooms and clinical additional expenses) will slightly decline in 2005 compared to the budget proposal for 2004. This implies that in 2005 operating and staff expenses will be inflation-adjusted, whereas the universities' means for investment will decline in real terms. The universities of applied sciences will receive additional financial means of € 45 million (+40.8 percent), because the number of subsidised university places will be increased.

Infrastructure investment will increase considerably in 2005, by 6.6 percent to € 4,048 million (*Federal Ministry of Finance,* 2004B). In the face of existing infrastructure deficits the rise of investment spending in this area is to be assessed positively. Since 1995 infrastructure investment went up by 7.8 percent altogether. The share of the federal level in total infrastructure investment has decreased dramatically due to the outsourcing of federal public enterprises[18] since the middle of the 1990s and because financial responsibility for federal streets was shifted to the states (2002): thus, the federal share in overall infrastructure investment will fall from about three fourth in 1995 to only 15 percent in 2005. The lion's share (about 83 percent) of additional investment planned for 2005 will be undertaken by outsourced public entities. The individual infrastructure areas will profit to differing degrees: the volume of building construction will fall, investment in railway infrastructure will remain at the level of the two preceding years; only the volume of road construction will rise (+15.4 percent).

Development of revenues

Federal revenues have been characterised by an uneven development during the last years, mainly because of the manifold changes in the tax code and the social security laws. The share of net tax revenues in total federal revenues went down between 2001 and 2003, but increased again in 2004 (mainly due to the one-time effect of the abolishment of the 13th VAT instalment), and it will fall again in 2005 due to the tax losses caused by the tax reform. At 64.6 percent it will, however, still be higher than in 2002.

The share of tax-like revenues (mainly unemployment insurance contributions, employers' contributions to the Family Burden Equalisation Fund, and federal shares of income taxes) has been increasing continuously since 2001; in 2005, however, the share of this item will decline to 16.2 percent of total federal revenues, primarily because of the drop in revenues from unemployment insurance contributions (–5.6 percent). The actual growth of unemployment insurance contributions (+2.1 percent) fell short of the budgeted one (+8.3 percent) in 2003; the 2004 budget estimates also appear overly optimistic. In recent years, unemployment insurance contributions have been dampened not only by the slowdown in wage increases, but also by the elimination of unemployment insurance contributions for older employees.

Other revenues will expand by 6.9 percent in 2005, so that their share in total federal revenues will increase to 19.3 percent. Of particular importance are property incomes (+13 percent in 2005); the second tranche from the sale of BUWOG (Federal Building Association) will raise revenues of almost € 380 million. However, revenues from federal shares will be lower by € 135 million than in 2004. Dividends of ÖIAG (€ 250 million in 2005, € 100 million in 2004) are expected to increase, and dividend distributions by BUWOG and Monopol Verwaltungsgesellschaft are estimated at € 100 million. However, dividends from the OeNB will fall markedly to € 255 million. The continued sale of federal property and the sale of federal shares planned in the medium term (ÖIAG) will further reduce the revenue potential in this area.

the universities from 2004 on and therefore do not appear any more in the federal budget, amount to € 130 million.

[18] Postal and Telegraph Administration, ASFINAG, SCHIG, BIG.

Table 13: Economic breakdown of federal revenues

	2002 Outturn	2003 Outturn	2004 Budget proposal	2005 Budget proposal	2003 Outturn	2004 Budget proposal	2005 Budget proposal
	Million €				Percentage changes from previous year		
Taxes, net	36,666	35,468	38,616	37,483	– 3.3	+ 8.9	– 2.9
Tax-like revenues	8,838	8,969	9,640	9,383	+ 1.5	+ 7.5	– 2.7
Others	12,035	12,523	10,461	11,182	+ 4.1	–16.5	+ 6.9
Total	57,539	56,960	58,717	58,048	– 1.0	+ 3.1	– 1.1
	Percentage shares						
Taxes, net	63.7	62.3	65.8	64.6			
Tax-like revenues	15.4	15.7	16.4	16.2			
Others	20.9	22.0	17.8	19.3			
Total	100.0	100.0	100.0	100.0			

Source: Federal Ministry of Finance, WIFO calculations.

Decrease in tax revenues and further shift of the tax structure

Gross tax revenues will decline by 2.3 percent to € 56.31 billion in 2005 compared to the 2004 budget proposal, due to the tax losses caused by the tax reform and the stimulus packages. Accordingly, the gross tax ratio will decrease to 23 percent of GDP in 2005: from 24.6 percent of GDP according to the budget proposal for 2004 and 23.9 percent of GDP according to the latest tax projections for 2004, respectively.

Table 14: Structure of gross tax revenues

	Taxes on income	Taxes on consumption: Total	Taxes on consumption: Energy-related taxes	Property-related taxes
	As a percentage of total gross tax revenue			
1990	42.9	50.6	4.6	4.1
1991	44.5	49.0	4.4	4.1
1992	45.2	48.4	5.4	4.1
1993	45.2	48.6	4.9	4.0
1994	42.4	53.6	5.2	1.9
1995	46.7	50.8	6.0	1.7
1996	47.2	50.7	6.5	1.6
1997	48.9	49.0	6.7	1.4
1998	48.1	47.9	6.1	1.3
1999	47.9	49.8	6.4	1.4
2000	47.0	50.5	6.5	1.4
2001	50.8	47.1	6.5	1.3
2002	48.5	49.3	6.9	1.2
2003	49.5	49.2	7.5	1.3
2004	47.7	50.3	7.4	1.2
2005	45.8	52.4	7.9	1.3

Source: Federal Ministry of Finance, WIFO calculations.

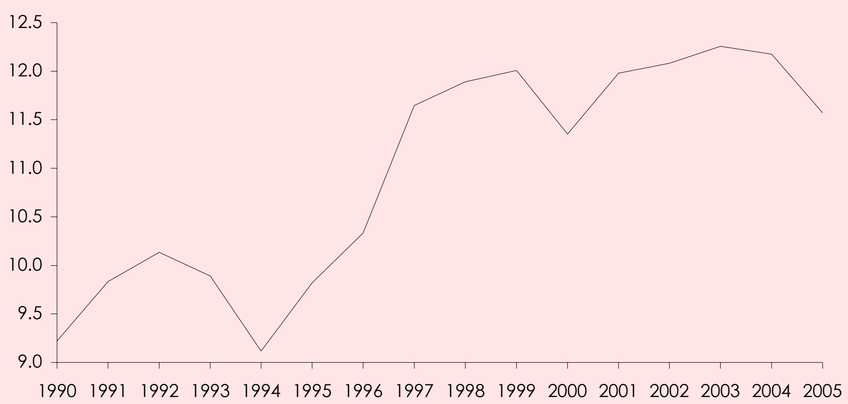
The decrease in gross tax revenues will affect federal net tax revenues as well as federal transfers to other public entities (states, municipalities, federal funds, hospitals, and residential water management) and to the EU. Compared to the budget estimates for 2004, federal net tax revenues will fall by 2.9 percent to € 37.48 billion in 2005, the net tax ratio (16.6 percent of GDP in 2002) will be reduced to 15.3 percent in 2005. Transfers to other entities will decrease by 1 percent to € 16.44 billion, the transfer to the EU budget will decline by 0.6 percent to € 2,385 million.

The weakness of the economy during the last few years together with the tax reform and the tax breaks granted within the stimulus packages have accelerated the structural shift in tax revenues. The share of direct taxes in overall gross tax revenues tended to increase between 1990 and 2001, but has declined since then and will reach a value of 45.8 percent[19] in 2005. Together with the latest increases in indirect taxes (energy taxes, tobacco tax), which are only partly compensated by reductions in other indirect taxes (beer tax, sparkling wine tax, and vehicle tax), this results in a marked increase in the weight of indirect taxes, attaining a share of 52 percent in total gross tax revenues in 2005. The introduction of energy taxes and their repeated increases as well as the gradual increases in the mineral oil tax will raise the contribution of these taxes to overall gross tax revenues in the long run (7.9 percent in 2005) and thus will strengthen the ecological elements within the tax system. Property-related taxes have become insignificant after the abolishment of the property tax in 1994.

A continuation of this structural shift from direct to indirect taxes may reduce the potential of the tax system to stabilise the business cycle. Moreover, the redistributive potential of the Austrian tax system (which is rather limited anyway; *Guger,* 1996) will be diminished further. The tax system's overall yield potential will decrease as well, as the revenue elasticity of indirect taxes (in relation to GDP) is smaller than that of direct taxes. This dampens the "automatic" upward trend of the tax ratio, which results from the relatively high revenue elasticity of direct taxes. However, in the long run direct and indirect taxes should be balanced in a way that prevents the erosion of the tax system's overall revenue potential and ensures that its stabilising and redistributive effects are not overly diminished.

In 2003, the increase in wage tax revenues by 4.5 percent to € 16.94 billion exceeded expectations. But, as a result of moderate wage increases and of the tax cuts effected by the tax reform, revenues from the wage tax increased by no more than 2.1 percent in 2004. The tax cuts provided for by the second phase of the tax reform will over-compensate the positive effect of higher wage gains in 2005, and wage tax yields will fall by 1.7 percent (to € 17 billion).

Figure 2: Wage taxes as a percentage of gross mass income



Source: Federal Ministry of Finance, WIFO calculations. 2004 and 2005 according to budget proposals.

The wage and income tax cuts (particularly the reform of the tax scale, surcharges for the sole earner and the lone parent tax credit, increase of the earnings limit for the sole earner tax credit, increase of the commuting tax allowance) amounted to € 529 million in 2004, and are expected to increase to € 1,650 million in 2005. The long-term trend of an increasing wage tax burden on gross mass income will be disrupted by the 2004-05 tax reform: in 2004, the share of wage taxes in gross mass income slightly decreased to 12.2 percent; the second phase of the tax reform will depress this share significantly to 11.6 percent. However, it will still be higher than in 1990 (9.2 percent).

[19] The fluctuations within the share of direct taxes in the period from 2000 to 2003 roots also in the introduction of the interest charges on tax areas within income and corporate tax in 2001.

The goal of the consolidation path pursued by the federal government is a "zero deficit" in 2008. The current deficits are the result of the asynchronous development of revenue and expenditure ratios: public revenues have been decreasing faster than public expenditures since 2001. To reach a balanced budget in 2008, the expenditure ratio must converge towards the revenue ratio. This requires the adoption and the realisation of structural measures aimed at limiting the dynamics of public expenditures. Some of these measures have not been concretised yet (reform of the health system, reform of the intergovernmental distribution of tasks), some have already been initiated (pension reform, ÖBB reform, administrative reform). If the envisaged goal of decreasing the expenditure ratio, an essential element of the current consolidation path, cannot be realised, short-term measures designed to cut expenditures will be necessary to avoid persisting deficits. From the perspective of a rational budget policy which has a long-term orientation and aims at providing stable and reliable conditions for the decisions of private agents, such stopgap measures should, of course, be avoided.

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Budget Proposal for 2005: Tax Reform Causes High Public Deficit – Summary

The budget proposal for 2005 is mainly characterised by the tax cuts effected by the 2004-05 tax reform. Together with the budgetary effects of the stimulus packages, which were introduced as a counter-measure to the weak economic growth during the past three years, they will increase the overall budget deficit to 1.9 percent of GDP. At the federal level, the budget deficit will reach 2.4 percent. Overall, the expansionary effect of the federal budget will be larger in 2005 than it has been in the preceding four-year period.

While total revenues at the federal level will decline by 0.6 percent compared to the 2004 budget, total expenditures will rise by 2.1 percent. According to the budget proposal for 2005, the federal expenditure ratio will fall to 25.9 percent of GDP, and the revenue ratio will decrease to 23.8 percent of GDP. Federal transfer expenditures will gain in importance again: mainly because of surging family-related transfers, but also due to growing expenditure for old-age pensions.

The tax reform of 2004-05 will bring about a reduction of federal tax revenues as well as a further shift in the composition of total tax revenues: the share of direct taxes in total taxes will decline to 45.8 percent in 2005, while indirect taxes will rise to 52 percent of total tax revenues. The tax reform will also reduce the tax burden on mass income to 11.6 percent.

The government's long-term strategy to divest public enterprises and institutions is producing a long-term shift within federal expenditures, from expenditures for the provision of public services to financing expenditures. According to the budget proposal for 2005, financing expenditures will amount to about 57 percent of overall federal expenditures. Off-budget entities (spin-offs) are becoming more important at all levels of the state: their share in investment, employment and the national debt is continuously increasing.

For the first time, initial steps have been taken within the budget proposal for 2005 to introduce gender budgeting, i.e., to perform a gender-sensitive analysis of budget policy.

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