7 MAIN RESULTS AND CONCLUSIONS

7.1 Economic Framework and the Fiscal Position of the Public Sector in Austria in 2009 (according to ESA 95)

Framework

- By November 2009 the extensive monetary and fiscal measures of central banks and governments in the course of the **financial and economic crisis** resulted in an almost complete normalization on financial markets after which tensions once again increased. Doubt about Greece's public-debt sustainability led to distortions on markets that once again required economic measures. At the beginning of May 2010 the heads of state and heads of government of the EU agreed on a euro package to stabilize the community currency worth a total of EUR 750 billion (excluding support measures for Greece) (Sections 2.1 and 2.3).
- In **Austria** the global financial and economic crisis was accompanied by a dramatic slump in merchandise exports, industrial products, and investments. Even though private consumption demand remained limited, it still contributed strongly to stabilizing the economy. In total, in 2009 the **Austrian Economy shrank** by 3.5% on the preceding year (Section 2.3).
- **Interest rates in the euro area** showed a basic tendency to decline – on the backdrop of key interest rate decreases and exceptional liquidity assistance of the ECB. The **three-month interest rate on the money market** (EURIBOR) fell from 3.3% (January) to 0.7% in December 2009. In 2009 on an annual average the **yields** of 9- to 10-year **Austrian** government bonds were at 3.92%, below that of the previous year's yield average of 4.25%. While the yields experienced volatile phases in the first half of the year as a result of uncertainty, there was a downward development of interest rates in the second half of the year (Sections 2.1 and 4.1.1).

Development of revenues, expenditures and budget balance in 2009

- In 2009 the worst economic slump since 1930 had a significant impact on public budgets in Austria: the **budget deficit of the general government** rose to EUR 9.5 billion or 3.4% of GDP after being EUR 1.2 billion or 0.4% of GDP in 2008 (Table 7) and the **total debt of the general government** (Table 14) increased from 62.6% (end of 2008) to 66.4% of GDP (end of 2009) (Sections 3.3.1 and 3.4.1).
- Basically the **decline in revenues** as a **result of the slump in economic performance** (effect of automatic stabilizers) and the **tax reductions** (Tax Reform 2009) was the decisive factor in the **significant deterioration** of the **budget deficit of the general government**. Compared to a "standard scenario", in 2009 the loss of revenues of the government reached a magnitude of 2.5% to 2.8% of GDP (Section 3.3.1).
- Although **the overall tax ratio of the public sector** of Austria was significantly lower in 2009 as a result of the economic crisis and tax reductions, the gap to the euro-16 average remained nearly unchanged. With a tax ratio (tax revenues, actually paid-in and imputed social security contributions including EU own resources) of 43.7% of GDP in 2009, Austria's tax ratio was significantly higher than the euro-16 average of 40.4% of GDP (Section 3.3.1).
- In spite of economic stimulus programs and the effects of automatic stabilizers, **public expenditure growth** was 3.9%, lower in 2009 than in 2008 (+4.6%). On the spending side, **additional cyclical expenditures** (monetary social benefits, labor market packages, economic stimulus packages I and II, regional stimulus packages, etc.) were partly balanced out by **lower expenditures** in other areas (above all, outstanding delivery of only two military airplanes, price reduction of medicaments and a reduction of the value-added tax on medicine to 10%, discontinuation of the Austrian-Airlines capital transfer (Section 3.3.1).
- In 2009 the **public expenditure ratio** grew dramatically from 49.0% of GDP (2008) to 51.7% of GDP (2009) due to the decline in GDP. A lower GDP level means, ceteris paribus, that there will also be a higher government expenditure ratio (Section 3.3.1).

- In 2009 not only the budget balance but also the **primary balance** (budget deficit not including interest payments) was negative (EUR -2.0 billion or -0.7% of GDP). In order to achieve a **stabilization of the debt ratio**, **primary balance surpluses** are required in the case of negative interest growth differences (nominal GDP increase is less than the average interest rate of the public debt). These required primary budget surpluses increase, ceteris paribus, with the increase of debt and the accompanying additional interest expenditures (Section 3.3.1).
- In 2009 the **fiscal position** of **all sub-sectors of the state** worsened significantly compared to the previous year with the exception of the **social security funds,** which showed high revenue growth that was due to additional federal transfers. The deficit ratio on the federal level rose dramatically to 2.7% of GDP (2008: -0,7% of GDP) and the moderate budget surpluses of the **provincial and local levels** of the previous year (2008: +0.2% of GDP) turned into a deficit in the amount of 0.8% of GDP in 2009 (Section 3.3.2).
- In addition to the **economic stimulus packages of the federal government** (budget effect for 2009 including tax reform: approximately EUR 3.2 billion) in 2009 the **provinces** also introduced stimulatory measures. The provinces (including Vienna) estimated their **packages of measures** to be in the **range of a total amount** of EUR 1 billion; however parts of this amount (among other things, guarantees, granted loans) are not reflected (or not directly reflected) in the public budgets. An estimate of the volume of these additional budget-relevant regional measures according to Maastricht has not been presented (Section 3.3.2).
- In 2009 the **bank rescue measures** of the federal government to **stabilize** the **Austrian financial market** reduced the Maastricht deficit slightly (2009: EUR 80 million). These direct payments from the bank rescue package present only one aspect. Historical experience shows that in particular the **indirect, macro-economic effects of a financial crisis** pose a considerable burden on the public budget (Section 3.3.1).
- **On an international comparison** in 2009, in spite of the **EU opening procedures** due to an **excessive deficit, Austria** positioned itself among those countries with a relatively low budget deficit (Luxemburg, Finland, and Germany). The financial and economic crisis caused a massive deterioration in the budget situation in Ireland, Greece, the UK, and Spain with deficit rates for 2009 at 11.2 % to 14.3% of GDP. No EU member state achieved a budget surplus in 2009 (2008: 8 countries of the EU-27). The deficit rate of the EU countries in summary (euro-16: 6.3% of GDP; EU-27: 6.8 of GDP) was significantly above Austria's ratio, which was 3.4% of GDP (Section 5).

Public Debt according to Maastricht 2009

- In light of the high deficit in the public sector and a lower GDP, **the public debt ratio according to Maastricht** increased significantly in 2009. At the end of 2009 Austria's total public debt reached EUR 184.1 billion or 66.4% of GDP following a deficit of EUR 176.5 billion or 62.6% of GDP at the end of 2008 (Section 3.4.1).
- In 2009 by 2.7 percentage points of GDP, the increase of the **public debt ratio** on the **federal level** turned out to be the most striking; however, in the same time frame, high debt growth was also recorded on **other sectoral levels**. In 2009 the debt ratio on the provincial level rose by 0.5 percentage points, that of the local government level by 0.2%, and that of the social security institutions by 0.3 percentage points. In 2009 in terms of absolute amounts, the **public debt position** rose by a total of EUR 7.6 billion (Section 3.4.1).
- The **debt structure of the public debt** in Austria is shaped by the federal debt: the federal government covers its funding requirement mainly by euro bond issues, which to a great extent are purchased by foreign investors (in particular in the euro area). In 2009 for the first time since the beginning of the European Monetary and Economic Union, the **share of foreign debt** did not increase. The share of government debt securities owned by foreigners fell from 82% (end of 2008) to 79% (end of 2009). The Austrian **bank sector** was the most important government debt **domestic creditor** with a share of 12%. At the end of 2009 **private investors** (firms and private households) directly held less than 2% of the total government debt (Section 3.4.2).

Midterm development of revenues and expenditures (2005 – 2009)

- Within the period 2005 – 2009 **social benefits in kind to private households** and **subsidies** – with a share of total expenditures of 11% respectively 7% – recorded the highest average increase with an expenditure share of 5.6 respectively 5.4 per annum. The development of social benefits in kind reflects mainly the increase in the cost of **health** and **long-term care**. The high dynamics in the expenditure category **subsidies** stems mainly from the provincial level and is directly associated with the spun-off **provincial hospitals** and their funding requirement (Section 3.5.1).

- **Monetary transfers to private households**, which tie up around 37% of the total volume of public expenditures, recorded an increase of 4.2 per annum on average from 2005 to 2009, which was slightly **above the government's total annual expenditure growth** of 4.1%. First of all, the budgetary effects of the measures passed in the National Assembly in September 2008 before elections to increase the purchasing power of private households (inflation package) came to bear and as a consequence of the crisis, the automatic increase in expenditures (unemployment, emergency assistance, and welfare payments). All in all, between 2005 and 2009, in particular, the **pension benefits** and **benefits according to the unemployment insurance law** showed above-average growth.

- Governmental **personnel expenditures** (employee compensation) that accounted for 19% of total expenditures in the most recent past recorded an above-average annual increase of 4.3% in the period under review. This development clearly shows that the agreed personnel cost goals and personnel numbers (Administrative Reform II: Reduction of personnel costs 2006 – 2010 by EUR 1.9 billion or 15,667 full-time equivalents) were not implemented. The development of personnel costs reflects a slight increase in the number of employees of the state in these five years (Section 3.5.1).

- For years **direct public expenditures** for **investments** have been low. In 2009 by absolute numbers gross investments amounted to EUR 3.0 billion or 1.1% of GDP. If the **investments of the spun-off units** that were previously part of the government sector were included in government investments, the volume of public investments would be doubled to almost EUR 6 billion. In addition, more than half of all local governments are likely to have spun-off infrastructure firms (local-government owned units of the private sector) that lower the investment volume on the local government level. (See **Special Topic**: Infrastructure investments in Austria: economic significance, investment volumes, and the role of the public sector as well as Section 3.5.1).

- In the period under review, **interest payments** for the **public debt** whose share was most recently 5% of total expenditures increased by an annual average of only 0.9% as a result of the decreasing market interest rate level and due to the relatively low debt growth in the years 2005 to 2007 (Section 3.5.1).

- On the **revenue side** the Tax Reform 2004/05 initially reduced tax revenues in the reporting period between 2005 and 2009. Subsequently tax revenues rose steeply until the end of 2008 due to the economic upswing. The financial and economic crisis was not evident until 2009. From 2005 until 2009 **tax revenues** developed in the range of +7.4 (2007) to -4.9% (2009) and reached an average annual growth of 3.1 % (Section 3.5.2).

- **Actual social contributions** recorded high increases of over 4% annually from 2005 until 2008 as a consequence of growing employment and increases in contributions. Although the slump in this revenue category was evident in 2009, it turned out to be less pronounced as a result of measures to promote employment and a higher federal-government contribution to pensions (2009: +1.3%; Section 3.5.2).

- In total, from 2005 until 2009 the **increase in public revenues** was on average 3.2% annually, whereas in 2009 in light of the recession and as a result of the Tax Reform 2009, there was a decrease in public revenues of 2.0% (Section 3.5.3).

- Although federal taxes shared with provincial and local governments are recorded directly as tax revenue of the respective public body (recipient) and the Fiscal Equalization Act (FAG) provided for a shift of transfers in the federal taxes shared with provincial and local government, in 2009 **intergovernmental revenue transfers** of the **provinces** covered **45%** (2008 48%) and those of the **local governments 16%** (2008: 17%) of the respective **overall revenues**. The intergovernmental revenue share from **social security institutions** was more than 25%. With a view to the expenditure side, the federal level essentially (co)finances services that are actually offered by other public bodies (among other things, province-employed teachers, investment contributions for residential housing, environment, and infrastructure, federal contributions to finance hospitals (up to 2008), conditional transfers according to the Fiscal Equalization Act 2008 (FAG), grants for sewage disposal and water supply). In 2009 total intergovernmental transfer payments reached approximately EUR 28 billion (that is 17% of total expenditures); of that approximately EUR 20 billion was accounted for by payments of the federal government (Section 3.5.3).

- Between 2005 and 2009, on an average annual rate, the **expenditure dynamics** on the **federal level** were much less pronounced than those of the provinces and local governments (Section 3.3.2).

7.2 The Federal Government's Debt Activities in 2009

- At the end of 2009 the **debt** of the **federal government** (not including own holdings of federal securities) reached EUR 168.7 billion or 60.9% of GDP and was thus EUR 6.7 billion or 4.2% above the previous year's figure. At the end of 2009 the **foreign-debt share** of the federal debt (after swaps) amounted to only 3.0% (end of 2008: 4.9%) (Sections 4.1.1 and 4.1.3).
- In 2009 the debt management of the federal government was confronted with extremely difficult and radically changing market conditions: thus **trading** on several important partial markets was only very weak; the **competition situation** among state issuers intensified; and the investors' **risk tolerance** remained low. Insecurities about macro-economic developments (e.g. Austrian banks' exposure in Central, Eastern, and Southern Europe) resulted in high interest-rate spreads (Section 4.1.1).
- Government issuers conducted road shows at which (international) investors were presented with extensive information about the present budgetary and economy situation of their respective countries. In 2009 such confidence-building measures were also taken by the Austrian Federal Financing Agency (ÖBFA) (Section 4.1.1).
- The **yield difference** of German government bonds to other euro countries' bonds widened dramatically in the course of the financial market crisis (euro-12-average not including Luxemburg 2009: 89 basis points; 2008: 42 basis points). In 2009 the yield difference of Austria to Germany in the 10-year segment was 68 basis points on an annual average. The strong cross-linking of Austrian banking institutions to Eastern Europe caused Austria's risk margin to temporarily further increase in 2009. In March 2009 yield differences of over 100 basis points were recorded (Section 2.1).
- Once again in 2009 the financing volume of the federal government was to a great extent covered by **euro federal bonds** in the total amount of EUR 23.7 billion (including own holdings of federal securities and third-party financing). In this connection, **syndicated issuing procedures** – by which the acceptance of the market could be sounded out - were used to a greater extent than in the previous years. Additionally, debt management changed to having **parallel auctions** with different terms in order to appeal to various investor circles (Section 4.1.1).
- At the end of 2009 the public debt (after swaps) had a **long remaining time to maturity** of 8.6 years and 95% of the debt obligations had a **fixed interest rate**. The goal set by the supervisory board of the Austrian Federal Financing Agency to keep the **effective duration** (average capital lockup period) in 2009 to approximately the level of the end of 2008 (6.05) was basically complied with in spite of difficult framework conditions and a relatively steep yield curve (end of 2009: 5.90; Sections 4.1.1, 4.2, and 4.3.1).
- The average **nominal interest rate** of the **federal government's debt** corresponded approximately to the average yield at the end of 2009 and showed once again a slight decrease in the year under review (2009: 4.1%; 2008: 4.2%). Due to the **low market interest rate level** more favorable refinancing was available, which explains the decrease in the nominal interest rates (Section 4.3.1).
- In the **year under review 2009**, the expenditure component **interest costs** for the federal government's debt hardly changed at all compared to the previous year in spite of the high net deficit of EUR 7.1 billion and amounted to EUR 6.74 billion (2008: EUR 6.63 billion). If the budget component **"miscellaneous expense"** is incorporated in this figure, the **expense for the federal government's financial debt** remained de facto on the level of the previous year (2009: EUR 6.72 billion; 2008: EUR 6.70 billion; Section 4.3.2).

- **Federal government** estimates for 2010 anticipate a dramatically increasing development of the **expense for the federal government's debt**. Although the budgetary amount (EUR 7.95 billion) for 2010 is likely to be overstated, the high increase in debt in the years 2008 and 2009 will, however, be accompanied by **higher interest expenses** in the coming years. As long as there is no return to the debt status in absolute figures by means of budget surpluses and/or asset transactions, financing costs (interest) will strongly increase budget expenses (Section 4.3.2).

7.3 Conclusions

- The **recession, which in historical comparison was deep,** and was caused by the global financial and economic crisis, required automatic stabilizers as well as government intervention to be brought into effect in order to support the lack of international and domestic demand and to be able to keep employment and private consumption in Austria reasonably stable.
- **The fiscal position of all levels of government** changed distinctly for the worse. Against the backdrop of the economic crisis the legally binding agreement of the **Austrian Stability Package 2008** is outdated.
- As a result of the crisis and the accompanying budgetary implications (rise in public debt ratio, increase of the structural and permanent budget deficit), the need for a **consolidation of public finances** has risen dramatically. This is particularly true, as the favorable economic situation and the high development of revenues **before the crisis** (2006, 2007, and 2008) were not sufficiently utilized for structural reforms to improve the quality of public financing in Austria.
- On Dec. 2, 2009, the European Council opened **excessive budget deficit procedures** against **Austria**. The EU has required Austria to gradually reduce its deficit ratio of the general government to below 3% of GDP by 2013 starting in 2011, which should also be accompanied by a lowering of the debt quota.
- Financial market dysfunctions and the economic crisis with their budgetary consequences showed that a **low-risk debt structure of the government** (among other things, a wide range of investors supported by a well balanced product mix as well as a term mix in funding, strict limitation of price and default risks, midterm to long-term debt maturities), an **observance of capital market requirements** as well as **fostering investor relations** are of utmost importance. Concerns about the sustainability of the public debt in several EU states do not give reason to expect a complete normalization of market conditions for debt management in Austria or in other countries in the near future.
- From the structure of the financial debt of the federal government at the end of 2009 it can be concluded that there is a **low interest rate sensitivity** of the budget-relevant **interest cash flow**.
- Since November 2009 the federal government and the Austria Federal Financing Agency (ÖBFA) have had up-to-date recommendations for efficient and risk-commensurate federal financial management **("Financial Management of the Federal Government")** at their disposal. In many respects these proposals confirm the practices pursued by the Federal Financing Agency (ÖBFA) within its remit. New recommendations refer in particular to the institutional sphere and the assessment of funding. These guidelines were also included in the recommendations of the Government Debt Committee of December 2009. Some important subareas are now implementing these guidelines.