Main Results of the Austrian Report on Public Finances 2002[1]

Economic Framework, the Fiscal Position of the Public Sector and the Federal Government's Debt Activities in Austria in 2002

Economic Framework and the Fiscal Position of the Public Sector in Austria in 2002

- Once again, real **economic growth** in **Austria** turned out to be low in 2002, amounting to only 1.0%. At the beginning of the year under review, a temporary stimulation of the Austrian economy, resulting from net exports, could be observed. However, this boom did not continue in the second half of the year – analogous to the developments in the rest of Europe. In addition, in summer 2002, the catastrophic floods in Austria resulted in production losses.

- The trend towards increasing **interest rates on the money market** in the euro area, which could be observed from the end of 2001, came to a halt in May 2002. The yearly average for three-month EURIBOR was 3.3% – close to 1 percentage point below the rate of the previous year. The **long-term interest level** demonstrated – particularly in the second and third quarters – a downward tendency. The yield on 10-year government bonds in the euro area sank by 10 basis points, on a yearly average, to reach 4.3% at the end of the year. The difference between the ten-year and three-month interest rates increased noticeably during 2002 amounting to 165 basis points, on average.

- The **current findings on the budgetary development in the public sector in Austria** (as of March 2003) show that the targeted budget goal of a balanced budget for 2002 could not be attained but that the budget deficit was significantly lower than expected at the end of 2002. Following a budget surplus amounting to 0.3 of the GDP in 2001, the budget deficit for the public sector for the year under review reached 0.6% of the GDP. Here, it is

[1] Source: Staatsschuldenausschuss, Bericht über die öffentlichen Finanzen 2003, Vienna 2004 (English version of chapter 8).

necessary to comment that the data available, for 2002, for the activities of the provinces and communities is still based on estimates. The final results of the budget performance of all public bodies (in accordance with ESA 95) are only made public with a delay of over one year (the final details for the year 2001 did not become available until March 2003).

- Influences resulting from the economic situation were the main reasons for the deterioration of the general government budget balance in the year 2002. However, other aspects also played a role in the increase in budgetary expenditure, and/or lower revenues, which could only partially be compensated for through the continuation of the consolidation course. The following aspects appear to have had a major influence on the total development:

- The **taxation revenue**, in 2002, was extremely subdued due to the unfavourable economic situation and in view of special effects (increased pre-payment of taxes in the previous year, interest on arrears, flooding). Substantial tax losses were the result of the economic situation. This was particularly the case with direct taxes (wage tax, income tax, corporate income taxes) as well as with the value added tax and municipal taxes.

- The strained situation on the labour market (decrease in those actively employed, increase in unemployment) required increased funds being made available on the expenditure side of the government's budget for the activities of the **unemployment insurance** and **pensions** (government subsidy for the pension insurance) and, at the same time, appears to have resulted in increased expenditure for social support on the part of the provinces and communities. The decline in the number of those actively employed also considerably reduced the **amount of social contributions**.

- As a result of the **catastrophic flooding** in summer 2002, it was necessary for all territorial authorities to provide additional funding to those affected in order to alleviate the damage caused.

- In addition, the **federal government** was subjected to **additional expenses** through the introduction of childcare benefits in January 2002, an increase in the number of the government employees retiring, through augmented payments to the Austrian Federal Railways and Post and through higher payments being made to public authorities (budget section 53).

- By their own account, the **provinces'** (including Vienna) agreed-on contributions to the inner-Austrian stability pact – amounting to 0.75% of the GDP or a minimum of 1.67 billion euros – were also provided in 2002. The budget surpluses of the provinces (including Vienna) were attained in spite of the weak economic environment and continuing dynamic development in expenditures for health care. Savings were made principally through the continuation of a reform of the organisation of responsibilities (a tightening of organisational structure, hiving-off of activities in line with the market, provincial real-estate companies (LIGs)), through a restrictive budget implementation, as well as, in some provinces, through a stop in personnel hiring. In addition, the course being pursued of selling claims on loans for housing subsidies and using them for setting reserves, for financial investments and/or for the clearing of debt, was continued.

- The **communities** (excluding Vienna) also provided the demanded stability contribution as foreseen in the inner-Austrian stability pact (balanced budget) despite a weak development in revenues and higher expenditures, particularly in the areas of social support and hospital financing as well as in the assumption of new administrative responsibilities (including registration activities). In addition to restraint in investment activities, it appears that the increased cooperation between the communities (for example, central purchasing, real-estate management), an increased use of leasing financing, as well as hiving-off and outsourcing played a major role in reaching the targeted zero-deficit. According to an up-to-date investigation into the financial requirements for 2002, the cautious investment activities of the communities, due to the strained financial situation of recent years, will lead to a backlog in the renewal and renovation of communal infrastructure.

- In an **international comparison**, Austria's financial position did not deteriorate in the year under review in spite of a turn in the budget from a slight surplus to a slight deficit. Since 2001, Austria has been counted among those countries with a close to balanced budget. In 2002, only Finland (+4.7% of the GDP) and Luxembourg (+2.6% of the GDP) had substantial budget surpluses. On average, the budget balances in the euro area decreased from -1.6% of the GDP in 2001 to -2.2% in 2002.

- The **revenues of the state as a whole** amounted to a total of 111.6 billion euros, or 51.5% of the GDP in 2002. **Expenditures**, for the same year, reached 113.3 billion euros or 52.2% of the GDP. Whereas the increase in the state's expenditures was approximately at the level of the nominal GDP growth, the revenue development was considerably below the increase in the GDP resulting in a declining development in the revenue ratio of the state and an almost constant course in the state's expenditure ratio (expenditure ratio of the state: 2002: 52.2% of the GDP, 2001: 52.1%; revenue ratio of the state: 2002: 51.5% of the GDP, 2001: 52.2%). The **expenditure ratio** of the state as a whole also decreased quite noticeably from 45.6% of the GDP (2001) to 44.5% (2002) and, therefore, once again reached the level of the years 1998 and 1999 (44.4% of the GDP).

- This report shows that more than 60% of the **state's expenditures** was used for **transfer activities to third parties** (social payments to private households and subsidies to enterprises), almost 30% for **public administration** (wages and salaries, material assets) and approximately 7% for **interest payments** on public debts. On the other hand, only approximately 2% of the total expenditure was used for **investments** (gross investments).

- **"Monetary social payments"** (above all, pension payments made by the social security funds and territorial authorities, unemployment benefits, family allowance, payments for parental leave and nursing), which accounted for 36% of the total expenditure in 2002, dominated the **transfer payments**. **"Social payments in kind"** – with 9.8% – also accounted for a relative high proportion of the total expenditure for the year 2002. Here, we are dealing with articles or services purchased by governmental authorities which are then redistributed, free-of-charge or at a flat rate (a contribution), to private households (this includes doctors' services, medication, kindergartens, free travel for students, free school books). Both categories (monetary social payments and social payments in kind) show an above-average dynamism compared over time. During the period under investigation (1998-2002) the total volume increased annually by an average of 2.3%, however the average increase in "monetary social payments" amounted to 3.6% and, in "social payments in kind," to 4.0%.

- Compared over time, it can be recognised that the public expenditure for **transfer payments to enterprises** ("assets transfer", "subsidies") always showed a very high rate of increase of over 10%, whereas the expenditure categories **"expenditure for material and personnel", "interest repayment"** and **"gross investments"** only showed a slight rate of variation which was below that of the growth of total expenditures. This contrary course was principally the result of institutional changes in the government sector (hiving-off of hospitals and of services in line with the market (e.g., water supply, sewerage treatment, garbage disposal, housing, congress houses, the federal real-estate company)) as well as of the declining market level in connection with interest costs. The lower growth rate in the categories "expenditure for material and personnel" and "interest repayment" as well as the decline in "gross investments" are also a result of consolidation measures taken by the territorial authorities, which resulted in reductions in personnel, low salary increases, savings in discretionary expenditures and/or measures to reduce debt.

- The **federal structure of public revenues and expenditures** shows that the weighting of the specific governmental levels on the individual expenditure and revenue categories, as well as on the total expenditure and revenue, varies greatly. There are close interconnections between the four individual sectors of the state which are demonstrated empirically through the high volume of **"intergovernmental transfers"**. Although the tax ratios of the individual administrative bodies, which are determined in the fiscal sharing Act, are booked directly as the tax revenue of the specific legal entities (the recipients), the intergovernmental transfer income of the provinces accounts for approximately one half of the respective total income and that of the communities, around one fifth. In the case of the social security funds, the federal contribution, in particular, results in an intergovernmental income ratio of more than 25%. If one observes the expenditure side, it becomes clear that the federal government mainly (co)finances services which are carried out by other public bodies (e.g., teachers in the provinces, housing subsidies, federal contribution to hospital financing, etc.).

- According to preliminary figures, **Austria's public debt, in accordance with Maastricht**, reached 146.6 billion euros or 67.6% of the GDP at the end of 2002. This was 3.9 billion euros or 0.3 percentage points above the comparative value for the previous year. In this respect, Austria failed to meet the Maastricht criteria concerning the level of debt (upper limit of 60% of the GDP or declining debt ratio) for the year under review. However, this fact must be strongly qualified seeing that the debt ratio increase is solely the result of a new EUROSTAT assessment, dating from January 2003, concerning **federal financing for third parties (intermediary funding)**. Here, the federal government is only granted an intermediary function, which it observes by taking on debts, in its own name, but then transferring them to the principal so that the financial responsibilities are juxtaposed with financial demands in the same amount. This means that, de facto, or seen **in net terms**, the federal government is not subject to any financing costs (interest, repayment) if expenditure and revenue are taken into consideration. Without intermediary funding of legal entities, a declining development in public debt – measured against the GDP – would be observed (year end 2002: 134.9 billion euros or 62.2% of the GDP; year end 2001: 133.1 billion euros or 62.8% of the GDP): In addition – according to the federal government's current stability programme from March 2003 – the debt of the legal entities to the federal government should be repaid, in total, by the end of 2008.

- **As a summary**, it could be established that the public budgets in Austria continued on a strict, consolidation course during 2002. In addition to the international stipulations (the EU's stability and growth pact) – the inner-Austrian stability pact, which came into operation, backdated to 1 January 2001, and set limits for the budget balances of the individual territorial authorities, in order to reach a balanced budget balance for the state as a whole, also played an important part. In connection with the "quality" of public finances, the available results – along with the expected economic and budgetary implications, which are the result of demographic changes – signal challenges in respect to the taxation ratio, the course of gross investments as well as the budgetary development of the hived-off entities. An intensification in those elements which stimulate employment and growth in Austria's public budgets appears to be hardly possible without additional reform measures being implemented in the area of the public administration which lead to a disentanglement of competences and funding responsibilities. The Government Debt Committee saw the departure from the budgetary goal of a balanced budget for the year 2002 as being necessary in order to allow the automatic stabilisers, with their properties of stabilising the economic situation, to take effect. Structural reforms, in accordance with the recommendations of the Government Debt Committee, however, appear to be necessary, in the future.

The Federal Government's Debt Activities and the Creditors' Structure in 2002

- The **debt of the federal government** (without own security holdings and the financing of third parties) increased more strongly in 2002 than in the previous year, due to the higher net deficit (2002: 2.5 billion euros or 2.1% ; 2001: 0.7 billion euros or 0.6%) and, at year end, amounted to 124.0 billion euros. Measured against the GDP, the federal government was still able to arrive at a stabilisation of the debt ratio (2002: 57.2% of the GDP; 2001: 57.3%). The **portion of debt in foreign currency**, included in the debt, decreased from 13.3% (year end 2001) to 12.7% at the end of 2002. The federal government's debt accounts for more than 90% of the total public debt, in accordance with Maastricht. Data on the structure of the federal government's debt therefore provides important information on the structure of the financing of the total public debt in Austria.

- The federal government's debt management continued on its course of concentrating its financing on medium to long-term EUR government bonds. For this reason, in 2002, around 75% of the **new debt** were in the form of **EUR government bonds**. Here, the increase in obligations led to a further increase in the volume of Austrian government bonds in order to keep the difference in their interest rates to those of the "benchmark bonds" in the euro area as low as possible. After an increase in the difference between the interest rates of the Austrian government bonds and those in Germany, in the ten-year segment, to more than 30 basis points in 2000, a decline began in the second half of 2001 and, in December 2002, lay by only 14 basis points. The 2002 yearly average of the difference in the yields for 10-year bonds, compared with Germany, amounted to 18 basis points (2001: 28 basis points).

- The **financing activities of the federal government in the year under review, 2002** – as in the previous year – were not limited to obtaining capital to cover the gross financial requirements of the federal government (net deficit and redemption) but also served to manage the debt portfolio (portfolio management) in connection to maturity, interest arrangements and currency structure, in order to guarantee the rapid adjustment of the debt structure to the prevailing market situation. This situation can, once again; be depicted in the increase in the claims and obligations from **swap contracts**. The restructuring of existing obligations in the form of **conversions** was used to a considerably lesser degree than in the previous year. This development can be principally led back to the fact that conversion agreements from the past increasingly phased out and the quantity of prematurely redeemable debts reduced permanently.

- Since the end of August 2002, the federal government has implemented a **new electronic financial product** with small investors (households) as its target group. The so-called "**Bundesschätze**" (Treasury bills) are bearer securities and can only be obtained, via the internet, from the Austrian Federal Financing Agency. These "Bundesschätze" have a denomination of 0.01 euros and a maturity of thirty years (1 July 2002 – 1 July 2032). However, for the investor, these are short to medium-term obligations with a commitment period of 1, 3 or 6 months which – if no termination is made – are extended. Within the period of commitment, the interest rate, valid at the day of deposit or day of maturity, applies which is orientated on the money-market rates in the euro area (EURIBOR rates for 1,3 or 6 months) and published in the internet (www.bundesschatz.at). The investor is not faced with any risk concerning the rate of his securities as buying and selling of the papers always occurs at a market value of 100. The issued volume of the "Bundesschätze" amounted to 500 million euros, in the year under review. At year end, 112 million euros had been placed. The remainder of the volume of "Bundesschätze" in circulation was in the sales stock of the seller and/or in the federal government's asset portfolio.

- The outstanding volume of the **federal government's obligations in foreign currency** has remained more or less constant since the introduction of the EMU. The main reasons for this are the attractive financing possibilities in the euro area which permit the federal government to take advantage of the wide range offered by an international financial market in domestic currency, as well as the efforts of debt management to limit the exchange-rate risks by setting ceilings in connection with the amount of debt in foreign currencies. In 2002, the year under review, there was a restructuring **in the currency composition** towards the Swiss franc. Whereas, at year end 2001, the CHF portion of the debt in foreign currencies amounted to 49.7% and that of the Japanese yen 50.3%; this had changed to 54.8% for the Swiss franc against 45.2% for the Japanese yen at the end of 2002. This measure was appropriate in the year under review when the exchange rate of the Japanese yen was low, compared with the euro, and that of the Swiss franc high. In addition, there is statistical evidence that, in the past, the Swiss franc was characterized by a lower exchange-rate risk (volatility and possibility of revaluation) than the Japanese yen.

- The implementation of the EMU was accompanied by the cessation of the traditional role of Austrian finance intermediaries as the main investors in the federal government's debt. In the meantime, **foreign investors** (principally from the euro area) finance more than 60% of the federal government's total euro and foreign currency obligations. At the end of 1998, the federal government's foreign debt was still below 40%. This dynamic development in the federal government's foreign debt is the result of the bidders' behaviour within the framework of the tender for EUR government bonds and has no connection with the foreign-currency debt of the government. Since the EMU, the purchasers of federal bonds, denominated in euros, have been almost exclusively foreign primary dealers (banks) who are a part of the bidder consortium, who place these papers abroad (mainly in the EMU area). This tender procedure led to foreign investors taking on over 89% (2001: 88%) of the volume of bonds issued in the year under review amounting to 13.4 billion euros (including 10% equity ratio and legal entity financing).

- The interest rates, which continued to remain very low in 2002, as well as the resulting repayment profile (high volume of repayment in the coming years) make it appropriate that financing with fixed interest rates and for a long-term be given preference in order, on the one hand, to maintain low interest costs over the longest possible period and, on the other, to limit the risk of refinancing (risk of changes in the interest rates). Of the remaining obligations of the federal government, 91.4% had a **fixed interest rate** (2001: 90.3%). Financing instruments with **money-market conditions** accounted for 5.0% of the federal government's obligations at year end 2002 (2001: 5.6%). The portion of titles with **variable or half-variable interest**, whose rates are dependent on the **yields of the money market** (secondary market, primary market) decreased from 4.1% to 3.6%.

- The **average nominal interest** rate for the national government's debt decreased, in the year under review, from 5.2% (year end 2001) to 5.0% (year end 2002). This development was triggered by the extensive redemption of categories of debt with a considerably higher nominal interest rate. The decline in the level of market interest rates in 2002 had hardly any impact on the nominal interest rate of the federal government's debt due to the higher portion of fixed interest rates in the debt, lesser financing over the money market and as a result of an increase in bonds. Here, it is necessary to mention that the parameter “nominal interest” only reflects the actual average interest rate (yield) of the federal government’s debt, to a limited degree, as a result of the recent practice of supplementing existing obligations.

- The reports of the Government Debt Committee traditionally select a so-called **net representation** for the **debt expenditure** (in accordance with the budget chapter 58 “debt, currency exchange contracts” of the federal budget), which includes **other expenses** such as offer-price losses and/or profits (disagio and/or agio), commission and expenses, in addition to **interest payments**. The net representation is the result of expenditures less revenues from budget chapter 58 and, in this way, takes, above all, those interest cost effects, which result from the implementation of derivative financing forms, into consideration. In spite of a budget deficit of 2.4 billion euros in 2002, the expenditure component **interest costs** for the debt hardly increased, in comparison with the previous year (2001 and 2002: rounded-off 6.6 billion euros in both years) due to the fact that those debt categories with a higher nominal interest rate, compared with that currently prevailing, were redeemed to a large extent. In addition, the expenditure for the budget components **other expenses** almost completely balanced with that for revenues at zero, so that the **total expenditure for the debt** also amounted to 6.6 billion euros.

- If one compares the debt of the federal government with key-data for the national economy, one recognizes, on the one hand, that the **interest payments** for the federal debt represent an important expenditure position but, on the other, that the pressure on the budget could be somewhat lessened. This mainly occurred as a result of the federal government’s consolidation course and the declining market interest rate, as well as through cost-dampening debt management measures. In this way, the **interest payment ratio** (measured against the GDP) once again decreased (2002: 3.0% of the GDP; 2001: 3.1%) in spite of the weak development in the economy. However, interest payments (including other expenses) still absorb almost one fifth of the net expenditure of the federal government (budget chapter 52 “public expenses”).