Main Results of the Austrian Report on Public Finances 2004[1]

Economic Framework, the Fiscal Position of the Public Sector and the Federal Government's Debt Activities in Austria in 2004

Economic Framework and the Fiscal Position of the Public Sector in Austria in 2004

- In the year 2004 – after a phase of economic weakness, lasting several years – there was a discernible upswing in the Austrian economy. The **real GDP** increased over the year by 2% (2003: +0.8%). According to the spring forecast of the European Commission, Austria's economic performance showed the same growth rate as the euro area, which saw itself confronted with an almost stagnant domestic demand.[2] In Austria, the dynamism in foreign trade – export of goods showed a real increase of 12% in 2004 – has, so far, only been reflected to a limited degree by the domestic demand.

- In 2004, the ECB council left the key interest rate unchanged at 2%. Parallel to this, the **interest rates on the money market** hardly changed in the year under review. Over the year, the average for the three-month EURIBOR was 2.11%, 22 basic points below the reference value of the previous year. The development of **long-term bond yields**, in the euro area, was marked by the evaluation of the inflation and economic outlook changing over time. Initially, the interest rates on the capital markets fluctuated until the middle of the year with a slightly upward tendency. Following this, yields on the secondary market once again showed a downward trend. The 10-year interest rate, which was 4.2% in January, increased to 4.4% by July and, following this, decreased to a, historically seen, extremely low level (December: 3.7%). The

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[1] Source: Staatsschuldenausschuss, Bericht über die öffentlichen Finanzen 2004, Vienna 2005 (English version of chapter 7).

[2] The most recent calculations indicate that, in 2004, the Austrian GDP growth lay slightly above that of the euro area.

yield curve flattened considerably over the year as a result of the decline in long-term yields.

- The most recent results – provided in March 2005 by Statistics Austria – for the **budgetary development of the public sector in Austria** for the **year 2004** confirm, on the whole, the expected development: after a budget deficit of 1.1% of the GDP in the year 2003, it appears that the budgetary deficit for the public sector for the year under review increased slightly to 1.2% of the GDP. However, it must be mentioned here that the data available for 2004 are only preliminary and, particularly in the area of the communities, are based on estimations. In contrast to the two previous years, the increase in the budget balance of the public sector was mainly the result of discretionary measures as well as of structural factors.

- In the reported year – after a period of stagnation in the years 2002 and 2003 – the **tax revenue of the public administrative authorities** once again developed more dynamically although discretionary measures had a dampening effect. In addition to the improvement in the general economic conditions, the “ecologisation” of the taxation system, within the framework of the first stage of the tax reform package 2004/2005 (increase in taxes on energy) resulted in increased revenue. At the same time, lower revenues were the result of the first stage, and anticipated first components of the second stage, of the tax reform package (increase in tax-free income thresholds, benefits for retained earnings, additional tax allowance for single-income and single-parent households, increase in the earnings limitation of the tax allowance for single-income households). The total tax revenue for all bodies in the public sector, in accordance with the ESVG 95 (European System of Integrated Economic Accounts) definition, increased by 2.3 billion euros or 3.6% (2003: +0.4 billion euros or 0.7%) compared with the previous year. This development was primarily due to an increase in indirect taxes (mainly, value-added tax and taxes on energy) and to the assessed income and corporation taxes.

- On the **expenditure side**, reform measures implemented during the previous years helped to restrain the expenditure dynamism (pension reforms 2000 and 2003, administration reforms, personnel reduction, increased budget controlling). On the other hand, the budgets in the public sector were additionally burdened by the packet of measures taken in 2002 and 2003 to stimulate the economy as well as the growth and competitiveness package 2003, the claims on family benefit services, salary increases for public servants, increase in pension payments, the increase in unemployment and by the additional financial requirements in the areas of health and elderly-care.

- The **total revenue of the public sector** in 2004 amounted to 116.0 billion euros or 49.4% of the GDP and the **expenditure** totalled 119.1 billion euros or 50.7% of the GDP. The increase in both the expenditure and revenue of the public sector (+3.6% in both cases) lay below the increase in the nominal GDP which resulted in a marginally downward development in the **general government revenue and expenditure ratios**, (expenditure ratio: 2004: 50.7% of the GDP, 2003: 50.8% of the GDP, revenue ratio: 2004: 49.4% of the GDP, 2003: 49.5% of the GDP). Compared with the average for the previous five years, both the total revenue and total expenditure of the public sector showed a considerable increase in 2004 (average increase 2000 to 2004: public sector expenditure: +2.4% p.a., public sector revenue +2.6% p.a.).

- The **public sector tax burden** (tax revenues including actual social insurance contributions, in % of the GDP) decreased in the year under review for the third time in succession, albeit to a noticeably lesser degree than in the previous years (2004: 43.1% of the GDP, 2003: 43.3% of the GDP, 2002: 43.8% of the GDP, 2001: 44.8% of the GDP).

- The **sectoral distribution of the budget balances** in Austria shows a slight improvement in the federal sector, whereas a modest deterioration could be observed in the positive budget balances at the state and communal levels. The deficit of the federal sector decreased from 1.8% of the GDP (2003) to 1.6% of the GDP (2004) and the surpluses of the states and communities would seem to have decreased from 0.7% of the GDP (2003) to 0.4% of the GDP (2004). This divergent development between the federal level, on the one hand, and the state and communal levels, on the other, is partially due to a varying development in revenues, resulting from the delays during the intergovernmental division of the shared federal taxes. In a sectoral analysis of the public sector, attention must be given to the fact that the results are strongly dependent on the institutional and legal circumstances (distribution of responsibilities, taxation authority, fiscal sharing regulations) within the public sector. However, there were no essential changes in interstate regulations during the year 2004.

- In an **international comparison**, Austria's fiscal position can be seen as being very favourable. With a budget deficit of 1.2% of the GDP, in the year under review, Austria was considerably below the 3% ceiling of the Maastricht treaty as well as the average in the euro area (-2.7% of the GDP) and in the EU-15 countries (-2.6% of the GDP). Only Demark (+2.8% of the GDP), Finland (+2.1% of the GDP) and Sweden (+1.4% of the GDP) show high budget surpluses.

- Particular attention must be drawn to the fact that, in the reported year 2004, important **intergovernmental legislation** was enacted which should lead to a consolidation of the public-sector budgets in the coming years. In particular, the inner-Austrian stability pact and the fiscal sharing regulations for the years 2005 to 2008 (including supplementary provisions) will play a role. The inner-Austrian stability pact is intended to lead to a reduction in the federal budget deficit, as well as to an increase in the budget surpluses of the federal states, so that a balanced budget for the entire public sector will be reached by the year 2008. Within the framework of the negotiations on fiscal sharing, the compilation of measures was agreed on (administration reform II, health platform, structural reform of hospitals) which should increase the efficiency of the provision of public services and contribute to the planned consolidation path.

- If one analyses the **structure of public expenditures**, one is confronted with the following picture: more than 60% of the expenditures of the general government are used for transfer payments to third parties (social payments to private households and subsidies for businesses), almost 30% for the provision of public goods (wages and salaries, material expenses) and approximately 6% for the payment of interest on the public debt. A mere 2% of the total public spending is used for investments (gross investments). During the period 2000 to 2004, advance payments increased by an average of 1% p.a., employee remuneration showed a decrease of -0.6% p.a., transfer payments (to private households and businesses) an increase of 4.2%, respectively 3.8% p.a., and the repayment of the public debt and investments an average decrease amounting to 2.2% respectively 5.4%, p.a. The rather slight increases in the expenditure categories "material and personal expenses", as well as the reduction in gross investments are, partially, to be seen as a result of the consolidation measures of the public administrative authorities (reductions in personnel, low salary increases, savings in discretionary expenditure). In addition, institutional changes on the national level (spinning-off of hospitals and services close-to-the-market – such as water supplies, waste water treatment, garbage disposal, housing, congress halls, BIG (Government Real-Estate Company) have also been a factor.

- Primarily, **spin-offs** were responsible for the strong reduction in the investment expenditure of the state (2000: 3.1 billion euros, 2004: 2.5 billion euros) in the period under observation (2001 to 2004). If one adds the investment of the spun-off entities, which were formerly part of the public sector, to the government investments, one is presented with a different picture: the **gross investment of the state (including spin-offs)** amounts to 5 billion euros, with a slightly-increasing tendency in the nominal size (2004: 5.2 billion euros or 2.2% of the GDP; 2000: 5.0 billion euros or 2.4% of the GDP). Whereas, on the federal and state level, there was a general increase in gross investments during the period 2000-2004 (federal level: 2004: 1.9 billion euros, 2000: 1.4 billion euros; state level 2004: 1.0 billion euros, 2000 0.8 billion euros), the communities have, as a rule, decreased the volume of their investments – even taking investments in the spun-off organisations into consideration. The investments by the communities (including spin-offs) decreased from 2.6 billion euros (2000) to 2.2 billion euros (2004). However, investments in the form of leasing financing, which are of particular importance on the communal level and at least partially compensate for the reduction, are not included in this data.

- On the **revenue side**, taxation and social-security contributions play an important role in the financing of public expenditures. They cover 90% of the public sector's revenue. Additional sources of finance for the general government include production profits (service payments), income on the assets of the state (interest, dividends, license payments) as well as transfers (e.g., education fees and contributions, court fees) which, however, are comparatively unimportant measured as a percentage of the total revenue. Within this group of so-called "miscellaneous revenues," with a share of a little over 10%, production profits (payments for services such as hospital care, nursing homes and communal public utilities, above all) make the greatest contribution to financing. However, a trend towards a decrease, due to the spinning-off of units close-to-the market with a relatively high cost-covering level, can be observed.

- Although there are more than 100 **taxation categories** in Austria, ten of these provide approximately 90% of the total tax revenue. The largest individual tax is the value-added tax which accounts for more than the half of indirect taxes and almost 30% of total tax revenue. Income tax plays a similarly important role with respect to taxation revenue, covering almost 60% of the direct taxes and, also almost 30% of the total tax revenue. In general, approximately 52% of the tax revenue is supplied by indirect taxes.

- The federal **structure of the public sector revenue and expenditure** shows that the shares of the different public authorities on the individual expenditure and revenue categories, as well as on the total expenditure and revenue, differ greatly. Close involvement exists between the four partial sectors of the state which is demonstrated empirically by the high volume of **intergovernmental transfers**. Although the taxation share of the individual public administrative authorities, which is regulated in the fiscal sharing act, is booked directly as taxation revenue for the individual legal entity (recipient) the intergovernmental transfers cover approximately one half of the total revenues of the states and those of the communities around one fifth. The federal contributions to pension payments made to the social security funds results in an intergovernmental revenue ratio of more than 25%. If one observes the expenditure side, it becomes clear that, essentially, the federal level (co)finances services which are carried out by other public entities (teachers in the states, investment contributions for housing construction, environment and infrastructure, federal contribution to hospital financing, compensation for the handing-over of federal roads to the states, undesignated funds in accordance with the fiscal sharing act 2001). The dynamic development in the intergovernmental streams of payment, over time, is particularly noteworthy. The intergovernmental transfers (on the expenditure side) expanded by 3.6% p.a. during the period 2000-2004.

- According to provisional figures, the **level of debt under the definition of Maastricht** reached 150.9 billion euros at the end of 2004; an increase of 4.6 billion euros over the previous year (2003: 146.3 billion euros). Measured against the GDP, this resulted in a reduction in the debt ratio of 0.5 percentage points of the GDP from 64.7% (year-end 2003) to 64.2% of the GDP (year-end 2004). In accordance with the Eurostat findings of January 2003, debts for public entities (ÖBB, ÖIAG, ASFINAG, SCHIG, AC, MUQUA), made by the federal government, are to be included in the Maastricht debt. The federal government’s abstention from claims in connection with the public entity financing of the SCHIG and ÖBB (6.1 billion euros), in 2004, means, in the definition of debt of the EU, merely a shift from one position to another (from the section “third-party financing by the federal government” to “federal debt in accordance with the federal final budget account”). This abstention on the part of the federal government resulted in the interest and amortization payments from the debt no longer being refunded by the SCHIG and ÖBB and that, in future, the federal government be responsible for debt servicing.

- Diverging from the Eurostat findings – if one disregards the **financing of the federal government for public entities,** which from an economic point of view should be allocated to the private sector, there was a markedly higher increase in debt resulting from the federal government's abstention from claims in the course of the reform of the Federal Railways (ÖBB) in 2004. Without the intermediary financing of the public entities, Austria would have remained marginally under the Maastricht ceiling of 60% of the GDP (135.5 billion euros or 59.9% of the GDP) at the end of 2003. The debt ratio, without public-entity financing, increased in the year under review 2004 to 141.6 billion euros or 62.1% of the GDP.

- The **creditor's structure of the public debt** in Austria has changed dramatically since the realization of the EMU at the beginning of 1999. The percentage of the public debt owned by foreign creditors increased continuously from 48% in the year 1999 to 71% at the end of 2004. The shift of the distribution of ownership is, in the main, due to foreigners' purchases of federal bonds. The federal government covers its financial requirements, to a large degree, through the emission of euro bonds which are, almost totally, purchased by foreign investors (particularly from the euro area). Within the domestic sector, banking institutions have remained the most important creditors of the Austrian state (share at year-end 2004: 15%). Private investors (enterprises and private households) were in direct possession of securities amounting to only 1.2% (2 billion euros) of the total government debt, as of the end of 2004. The importance of private households as creditors of the public sector increases somewhat if one takes the indirect possession of government bonds, by way of investment funds, into consideration. At the end of 2004, this amounted to just under 3 billion euros.

- **As a conclusion**, it can be established that, in 2004, the general government in Austria continued on its consolidation course, albeit in a weakened form. In spite of the restrictive management of the expenditure positions which are not legally standardized, structural reforms for curbing the dynamism of expenditures in the previous years and a noticeably increased growth in revenue in the year under review slightly increased the budget deficit of the public sector. As a qualification, attention must be drawn to the fact that an isolated analysis of the public expenditure and/or revenue usually falls short seeing that, considerable interaction exists. In addition, in accordance with the booking conventions of the ESVG 95, the interactions manifest themselves to a greater extent than by national, budgetary booking regulations. First, expenditure positions having an impact on stimulating the economy lead, simultaneously, to an overall increase in governmental revenue. Second, in keeping with the booking conventions of the ESVG 95, public grants (subsidies, investment contributions) – usually independent of the form in which they are granted – are counted as an expenditure. In an international context, Austria's fiscal situation, with a budget deficit of 1.2% of the GDP in 2004, contrasts encouragingly with that of many other EU countries with their budget deficits of more than 3% of the GDP.

The Federal Government's Debt Activities and the Creditors' Structure in 2004

- The **debt of the federal government** (without own security holdings) reached a level of 135.6 billion euros at the end of 2004, lying 8.7 billion euros, or 6.8%, above the value of the previous year of 126.9 billion euros. In the year under review, an increase in the federal government's debt ratio, measured against the GDP, was registered for the first time since 1999 (end of 2004: 57.7% of the GDP, end of 2003: 56.1% of the GDP). The main cause for the noticeable increase in the debt in 2004 was the abstention from claims within the framework of the public-entity financing in the amount of 6.1 billion euros. In the process of the Austrian Federal Railways (ÖBB) reform, the federal government abstained from the claims on loans to the SCHIG and ÖBB which it held in its intermediary function.

- The **percentage of foreign currency debt** in the total debt once again decreased in the year under review 2004; this time pronouncedly from 11.0% (year-end 2003) to 9.7% (year-end 2004). In 2004, for the first time since the publication of the annual reports of the Government Debt Committee, no debts (after swaps) were issued in foreign currency.

- In the main, the federal debt management once again took advantage of the extremely low nominal interest rate level on the capital markets to implement **long-term financing at fixed interest rates**. The chosen term for new debts led, in 2004, to an average term to maturity of 10.6 years for gross borrowing (2003: 10.4 years). **EUR federal bonds** once again served as the primary source of financing. Their percentage in the gross borrowing for 2004 (taking swaps into consideration) amounted to more than 80%. Austria's emissions in the form of EUR government bonds reached a volume of 14.0 billion euros.

- The **difference in returns** (yields) between Austrian and German federal bonds, which have the "benchmark status" in the 10-year-maturity segment, hardly changed during the year under review. The annual average in 2004 for the difference in returns between 10-year German bonds was 5 basis points (2003: 4 basis points). Similar differences could also be observed with most of the other EMU countries vis-à-vis Germany (EMU average 2004: 6 basis points, 2003: 5 basis points – excluding Greece and Luxemburg).

- The **structure of the federal government's debt** in Austria, in 2004, shifted further in the direction of marketable euro debts. At the end of 2004, 77.2 % occurred in EUR federal bonds (2003: 76.2%) and 79% in all types of marketable euro debts (2003: 77.4%). The ratio of euro credit and loan contracts was stabilised in 2004 for the first time since the mid-1980s and, at year-end, lay by 11.3% (2003: 11.7%).

- The outstanding volume of the **federal government's foreign currency liabilities** (after swaps) has been slightly reduced since 2000. In the year under review, 2004, taking swaps into consideration, no new financing in foreign currency was undertaken. This was the first time since the publication of the Government Debt Committee's annual reports in 1970. The federal government's debt management did issue securities (mainly bonds in US$, CA$, AU$) but converted these, through swaps, into EUR debt categories. The outstanding amount of foreign-currency obligations, converted into euros, totalled 13.1 billion euros at the end of 2004 (2003: 13.9 billion euros). The percentage of Swiss francs and Japanese yen in the total foreign-currency debt hardly changed in 2004 (CHF quota: 2004; 59.5%, 2003: 60.0%; JPY quota: 2004: 40.5%, 2003: 40.0%).

- The realization of the EMU was accompanied by the discontinuation of the traditional role of the Austrian financial intermediaries as the **main investors in the federal government's debt**. From the volume of federal bonds issued in the year under review, amounting to 14.0 billion euros (including 10% own holdings and financing of public entities), foreign primary dealers took over around 88% either through tender procedures or within the framework of syndicated issues. If the federal government's own holdings are disregarded, it can be seen that foreign financial intermediaries took over almost 99% of the total of federal bond issues in 2004. In addition, in 2004, euro loans were also settled with foreign financial intermediaries.

- The historically low nominal interest rate in 2004 and the given redemption profile (high volume of redemption over the coming years) induced to enforce financing with fixed interest rates and for long terms. This would enable maintaining the low interest costs over a period as long as possible and, in addition, limiting refinancing risks (risks of change in interest rates). The quantity of **fixed-interest obligations of the federal government** (taking interest rate swaps and own holdings into consideration) increased dynamically to 10.0 billion euros or 8.5%. On the other hand, the indebtedness with variable interest rates (including half-variable interest) was reduced (2004: -1.3 billion euros or -14.5%). The average remaining time to maturity for the total debt portfolio increased considerably, for the second time in succession, in the year under review. At the end of 2004 the **average remaining time to maturity** was 6.4 years, lying 0.5 years above the value of the previous year.

- The average **nominal interest rate** of the federal government's debt could be maintained at the previous year's level of 4.8% in spite of the shift in the remaining time to maturity from 5.9 (year-end 2003) to 6.4 years (year-end 2004), in the year under review. This development was mainly the result of comprehensive repayments of debt categories with considerably higher nominal interest rates of up to 7.6%. The low market interest rate level in 2004 – approximately at the same level as in the previous year – also supported this development. Here, it must be mentioned that, due to the reopening of existing issues, the measure "normal interest rate" is only a limited reflection of the real average interest rate (rate of return) of the federal government's debt. The actual rate of return probably currently lies below the nominal interest rate.

- In accordance with chapter 58 "financing, currency swap contracts" of the federal budget, a so-called net concept of the **expense of the debt** is traditionally used in the Government Debt Committee's reports. In the year under review, 2004, the expenditure component "interest costs" for the debt hardly increased even though, in the years 2003 and 2004, the federal government registered net deficits (interest costs 2004: 6.36 billion euros; 2003: 6.30 billion euros). This welcome development can be primarily explained by the fact that a large number of debt categories with a higher nominal interest rate than the current level matured. If "miscellaneous expenses" are included, the costs for the debt were even somewhat lower than the value for the previous year (2004: 6.23 billion euros; 2003: 6.26 billion euros). In 2004, the costs for the budget component "miscellaneous expenditure" lay, once again, below those for "miscellaneous revenues".

- If the interest costs for the federal government's debt are compared with other parameters of the national economy, it can be seen that, on the one hand, servicing the debt of the federal government represents a substantial expenditure position for the government but, on the other hand, the burden on the budget was able to be diminished. In 2004, both the **interest-to-GDP ratio** and the **interest tax ratio** (measured against the net tax revenue of the federal government) showed a decrease (interest ratio: 2004: 2.7% of the GDP, 2003: 2.8% of the GDP; interest tax ratio: 2004: 16.5%, 2003: 17.6%). However, interest payments (including miscellaneous expenses) tie up a considerable amount of the federal government's taxation revenues (budget chapter 52 "public taxes"; net tax achievement).

- On the whole, a very low interest sensitivity can be deduced from the structure of the federal government's debt which, in 2004, the year under review, was further reduced as a result of a shift in the debt-profile towards long-term financing with fixed interest rates. Over the medium-term, however, it cannot be expected that the reduction in the nominal interest rate will continue at the level of the previous years. The positive refinancing effect (substitution of debt categories with the high interest rates of the past by those at a lower level) will probably become weaker. On the other hand, with the regrouping of the debt portfolio towards debt categories with a comparatively low interest rate, preferably fixed, and over a long period, it can be expected that the increase in the costs for interest will be comparatively low, even with a continuously increasing market interest rate level.