

SPECIAL TOPIC

The following chapter presents the main results of the study “**Government Guarantees for Non-public Entities in Austria – How Effective Are the New Guarantee Ceilings in Limiting Guarantee Risk?**” The study was carried out by Eva Hauth and Bernhard Grossmann, staff members of the Office of the Government Debt Committee, and commissioned by the Government Debt Committee. The long versions of studies commissioned by the Government Debt Committee are available on the Committee’s german website (<http://www.staatsschuldenausschuss.at/de/pub/publikationen.jsp>). The results and conclusions need not necessarily be in accordance with the assessments of the Government Debt Committee.

GOVERNMENT GUARANTEES FOR NONPUBLIC ENTITIES IN AUSTRIA – HOW EFFECTIVE ARE THE NEW GUARANTEE CEILINGS IN LIMITING GUARANTEE RISK?

Subject of the Study

The topics of **government liabilities** and the **sustainability of public finances** have gained importance on the backdrop of the financial and government debt crises. In **Austria experience from rescue measures in the banking sector** contributed to the fact that the federal government, provinces, and municipal governments agreed upon legally binding **maximum limits** on assumed liability (sureties, guarantees, comfort letters, etc.) The **Austrian Stability Pact 2011**, which became effective retroactively on January 1, 2011, laid down maximum guarantee limits to be set by federal and provincial law, requirements to provide information and also the creation of risk provisions. In accordance with the Austrian Stability Pact 2012 these legal requirements are not longer limited in time.

The topic investigated in the **present study** is the **legal implementation of determining maximum guarantee limits** of the individual levels of government (federal, provincial, and municipal governments) in regard to **normed objectives** in the Austrian Stability Pact (2011, 2012), **comparability** of legal requirements and the **completeness** as well as the **effectiveness** of **each level of government limiting its own risk**.

The potential budgetary burden arising from the given guarantees (the “**risk**”) results from the combination of the **absolute guarantee amounts** and the **default risk of the debtor**. The past years have shown that if the guarantee levels are high, claims arising from guarantee commitments jeopardize a public body’s room to maneuver and that the probability that a claim on a guarantee will be asserted can change rapidly in the recent economic framework.

In addition to **explicit guarantees** (or liabilities) there are also **implicit government guarantees** in “**systemically relevant areas**” in which the government accepts the function of insurer of last resort. Such (preventative) government aid measures – as with guarantee claims – can present considerable budgetary burdens and risks. “Implicit guarantees” are usually to be found in the **banking sector** (systemically relevant banks, such as, for example, UniCredit Bank Austria AG, Raiffeisen Zentralbank Österreich AG, Erste Bank der oesterreichischen Sparkassen AG) and in the **public services enterprise sector**.

The terms *guarantees* and *liabilities* are used synonymously in this study. Implicit guarantees in form of entitlements of the government within the scope of social securities systems are not part of this study.

The Federal Maximum Guarantee Limitation Act of 2012 (Das Bundeshaftungsbergengesetz 2012)

- The Federal Maximum Guarantee Limitation Act is the first to define **maximum guarantee limits** for any type of **liability on the federal level** (federal government including **off-budget units** in the sphere of responsibility of the federal government) for the years **2012 to 2014**. The limit determined in this act was set at **EUR 193.1 billion** or **63% of GDP**. For guarantees **without maturities** the **limit is about EUR 175 billion** or **57% of GDP**.
- The Federal Maximum Guarantee Limitation Act limits the **utilization of the guarantee capital to nominal values**. **Guarantee for interest and operative expenses** is not included in the **maximum limits**. Authorization of the National Assembly to justify **previous charges** is not of significance for the Federal Act. Also extending **contractual guarantee assumptions** or **limits** does not necessarily equate with exceeding the limit in the act, as the amount of guarantee may still be below the limit.
- Along with the Federal Maximum Guarantee Limitation Act, the **assumption of guarantees for off-budget units of the federal government, which**, according to ESA 95, is to be accounted for on the federal level, are limited to an **amount of EUR 100 million**. Organizations, such as **chambers, universities of applied science and research institutes** have **not been included**, as they are not in the primary sphere of responsibility of the federal government.
- The federal act standardized **maximum guarantee limits without weighting the risks**. Setting maximum limits without considering differing probabilities of occurrence may be justified in view of the **principle of prudence** and **corresponds** with the **agreements in the Austrian Stability Pact (2011 and 2012)**.
- There are **three areas** in which the method of how guarantees are factored in on the federal government level is to be questioned from the **economic point of view**:
 - From the economic point of view, the Österreichische Kontrollbank (OeKB) has active and passive liabilities in analogous business transactions in connection with **export promotion** that could be consolidated. As a result, the guarantee volume of the federal government at the end of 2011 would be reduced by **EUR 27 billion**.
 - The **financial institution deposit guarantee** at a volume subject to compulsory insurance of about **EUR 179 billion** (end of 2011) was set at capital of only EUR 7 million in the Federal Finance Act 2012 and Federal Maximum Guarantee Limitation Act. From the point of view of the authors, the deposit volume should be recorded as a **direct contingent liability** of the federal government **in case of default** (estimate EUR 22 billion, as the minimum amount) and the low **level in the Federal Finance Act** should be questioned.
 - **Parts of the assumed guarantee for infrastructure** division of the **Austrian Federal Railways infrastructure** (ÖBB-Infrastruktur) and **for EFSF guarantees** have already been recorded as **federal government debt according to Maastricht** (end of 2011: EUR 6.7 billion) and would not need to be recorded as contingent liabilities.
- **The maximum guarantee limit** of the federal government is likely **to be complied with** in the years 2012 to 2014: At the end of 2011, the assumption of guarantees by the federal government (not including non-budgetary units) for capital **from the economic point of view** came to approximately **EUR 103 billion** or **34% of GDP**, according to our own research. Of that amount, at least EUR 22 billion (estimate) was accounted for by “direct guarantees” of the federal gov-

ernment within the scope of **deposit guarantees**. The considerable **under-utilization of the maximum guarantee limit** (the guarantee commitment was about 53% of the limit at the end of 2011) was explained by the guarantee limit that was not completely utilized (mainly export promotion, EFSF), double counting from the economic point of view (export promotion, EFSF, Austrian Railway (ÖBB) guarantees) and from the circumstance that parts of the financial market stability law do not constitute any guarantee (e.g. participation capital, shareholder's contribution).

- Of the **guarantee commitments of the federal government from the economic point of view** (end of 2011), 39% of the guarantees were accounted for by **export promotion**, 21% by direct liabilities of **deposit guarantees** (estimate), 19% by the **assumption of guarantee as a result of the crisis**, mainly for refinancing of banks, 18% by guarantees to finance **transport** and 3% by other guarantees.
- **Provisions for guarantees** must be included in the budget if it is to be **assumed** that **guarantee** will **most probably** (more than 50%) be claimed. The allocation of funds in this connection amounted to EUR 15 million in the Federal Budget Estimate 2013 (Bundesvoranschlag). The **total guarantee limit** and the **degree of use** (guarantee commitment) of capital of the federal government and the off-budgetary units are to be recorded in the **Federal Budget Account** (Bundesrechnungsabschluss) (in the Federal Budget Account for 2013 for the first time).

Guarantee Limits for Provinces and Municipalities

- The **maximum guarantee limits** for **provinces** have been mainly set in the form of **decisions of the provincial parliaments** (Landtage) and those of the municipalities in the form of provincial **regulations**. In addition there are standardizations that limit the government default and guarantor liabilities (Ausfall- und Gewährträgerhaftungen) for provincial mortgage banks and municipal savings banks and specify their maturity.
- While the implementation of the requirements follows general **characteristic features**, there is a wide range of variation in some respects. For example, the provisions normally define **risk-weighted maximum limits** for **utilizing the guarantee capital (commitment excluding interest)** at nominal value. In contrast to that, the maximum limits valid in in the province of Upper Austria and Tirol as well as for the municipalities of Upper Austria and Styria are **maximum limits that do not include risk weighting**.
- The **maximum guarantee limits** that determine the **maximum permissible total guarantees of the individual administrative bodies at the end of the year**, with the exception of the province of Upper Austria, have been set **in relation** to certain **revenue categories** – usually in relation to public levies (Section 92 of the Balance of Accounts) – and in principle include **off-budget units** that are in the scope of responsibility of the respective administrative body. However, no processes have been standardized to identify the off-budget units.
- In view of the maximum limit, **individual provincial and municipal liabilities** are normally entered under total guarantees as **weighted**. The risk weightings were based on the **degree of the scope of influence** of provinces and municipalities. A low risk (generally between 0.0 and 0.3) was allotted to guarantees for units for which the administrative bodies have a controlling influence (predominant in the portfolio of liabilities). By means of this risk weighting the **requirements of Austrian Stability Pact** to limit the **guarantee risk** were implemented in a manner that is **not particularly restrictive**.
- **Bank guarantees** assumed by the provinces – except in Lower Austria and Upper Austria – were **excluded** from the general maximum guarantee limits and they do not provide additional room for manoeuvre when they mature. At the end of 2011, almost three-quarters (EUR 51.7 billion) of the guarantees assumed by provinces (including Vienna) were to banks – including the guarantee of the province of Carinthia for Hypo Alpe-Adria-Bank International AG in the amount of

EUR 17.5 billion. According to an EU requirement, the **default and guarantor liabilities** (Ausfall- und Gewährträgerhaftungen) for provincial mortgage banks and municipal savings banks will mainly mature by the year 2017.

- According to the Austrian Stability Pact (2011 and 2012) **risk provisions** must be created if it is very probable that the guarantee will be asserted. In some provinces and municipalities guarantees with low risk weightings have been completely **excepted** from the risk provisions. The **allocation** of risk provision is in the form of earmarked reserves or asset values.
- The individual **provisions** on maximum guarantee limits for provinces and municipalities **vary** both in their **applicability** (normed limitations concerning the guarantee provider (not including off-budget units in Burgenland and Vienna as well as in Upper Austrian municipalities) and guarantee takers (e.g. not including certain provincial enterprises such as the provincial holding company of Carinthia)) as well as in **determining the value of the guarantee** (amount and classification of the risk weighting, etc.). Altogether at the end of 2012 the **maximum guarantee limit of the provinces and municipalities** (including off-budget units) of **EUR 31 billion or 10% of GDP** was composed of the individual guarantee risk weightings (EUR 12 billion) and the limits that were not risk weighted (EUR 19 billion.). Of these sums, the maximum guarantee limit of the provinces (including Vienna) amounted to EUR 23 billion, that of the municipalities (not including Vienna) EUR 8 billion.
- It can be assumed that in 2012, **in spite of a higher guarantee commitment** of the provinces and municipalities, **the maximum guarantee limits were complied with**: On the other hand, according to official information, at the end of 2011, the **assumption of guarantees of the provinces and municipalities** (excluding risk weighting, including bank guarantees) at EUR 77 billion or 26% of GDP considerably exceeded the **maximum guarantee limit** defined for the end of 2012 of EUR 31 billion. These **limits** were composed of **risk-weighted** and **non-risk-weighted guarantees, while bank guarantees** – apart from Lower Austria and Upper Austria – were not included. At the end of 2011 over 50% of the **guarantee commitments of the provinces and municipalities** were accounted for by **provincial banks** (not including Lower Austria and Upper Austria) with a volume of EUR 42 billion that had not been included in provisions on maximum guarantee limits. Additionally the applicable value of the individual guarantees was considerably reduced by means of **risk weighting**.

Parameters on the Guarantee Commitment of the various Levels of Government

- The annual **revenues** on the federal level according to ESA 95 (consolidated) of about EUR 70 billion (23% of GDP) in 2011 covered almost 70% of the **guarantees assumed by the federal government** from the economic view of EUR 103 billion (34% of GDP) and 36% of the **maximum level of the volume of guarantees according the Federal Maximum Guarantee Act** of EUR 193.1 billion (63% of GDP). The **debt level of the federal government according to Maastricht** amounted to about EUR 189 billion or 63% of GDP at the end of 2011.
- On the **provincial and municipal level the debt level according to Maastricht** at the end of 2011 amounted to a total of EUR 27 billion or 9% of GDP and the **total revenues** (2011) to EUR 36 billion or 12% of GDP. The volume of **assumed guarantees** of the provinces and municipalities in the amount of EUR 77 billion or 26% of GDP (end of 2011; excluding off-budget units) was at about half covered by annual **total revenues**.
- The **sub-sectorial relations** in the area of **guarantees** and **debt** were characterized by large divergences: While on the provincial and municipal levels (excluding off-budget units) the share of the guarantee commitment of the general government was 43 % (and that of the federal level was 57%) the portion of the provincial and municipal level of the public debt level was 12% (that of the federal level was 88%).

Conclusions and Proposals for Expansion

- The **assumption of guarantee** by the **various levels of government** in Austria is connected with **economically significant spheres of activity**: By means of government guarantees **security and funding simplification** are provided for business projects (e.g. export promotion, assumption of guarantees for infrastructure enterprises, etc.) and measures to **stabilize financial markets** are implemented (e.g. deposit guarantee, EFSF, Financial Market Stability Act).
- In 2011 in **several federal provinces**, the guarantee volume was many times more (up to 20 times) than the revenues from public levies (Section 92), and thus the **budget** could become **overextended if claims are made on the guarantees**. On the other hand, provincial guarantees (including Vienna) **to banks**, which at the end of 2011 accounted for about three-fourths of the total amount, will mature by the year 2017. A closer study of default risks is not included within the framework of this study.
- It seems that on the **municipal government level** a considerable share of the budget risk is in the form of **contingent liabilities based on shareholdings**, which are not the subject matter of proof of a liability (implicit guarantees) or are not recorded as a liability.
- On the **federal level** it is necessary to bear in mind that the central state has the **macro-economic role of insurer of last resort**. Such (implied) **guarantees** present risks that are difficult to assess and vary in the course of time, yet should also be taken into consideration. These guarantees are mainly found in the area of “**strategic infrastructure**” (in the fields of **banks and public-service enterprises**).
- The **agreements in the Austrian Stability Pact** (2011 and 2012) led to the achievement that **for the first time all public bodies** were prepared to set **their own maximum guarantee limits** and to accept more transparency demands in regard to government guarantees. The requirements to implement the agreements, however, allowed **leeway**. Methodological requirements to determine maximum limits for guarantees and for their assessment and differentiation of terms (e.g. other contingent liabilities) are largely missing. In addition, in the Austrian Stability Pact (2011 and 2012) neither a legally binding **evaluation process** in connection with compliance with the maximum guarantee limits nor an adjustment process in the case the limit is exceeded is specified.
- The **risk limitation should take effect** based on the **maximum limit provisions** of the various levels of government. There are, however, restrictions due to the **partial approach** (guarantees included in contingent liabilities) and due to the fact that the **set maximum limits** (in absolute and relative terms) are very **likely** to be easily **adhered to** by the various government bodies. However, it seems as if **experience** connected with the financial and economic crisis and the **stricter transparency requirements** are playing a part in ensuring that cost/benefit and risk considerations in assuming guarantees will have a stronger impact.
- The **fiscal frameworks directive** of the EU, which is to be implemented **by the end of 2013**, was not only limited to guarantees, but included transparency requirements for “(explicit) **contingent liabilities**”, which can have a considerable effect on public finances. These provisions probably also involve contingent risks based on assets (e.g. granting of loans). **High contingent liabilities** combined with already **high debt ratios** constitute a **source of danger for the credit rating** of a country that should not be underestimated. Determining **maximum guarantee limits** and ensuring **high transparency** of all forms of liabilities are thus **important steps** in the direction of **reducing budget risks**.
- From the **risk point of view** it should be noted that the **economic differentiation among guarantees** (e.g. EFSF), **strategic shareholdings** (e.g. participation capital, ESM, infrastructure enterprises, provincial banks) or other **strategic investments** (e.g. granting loans) is **hazy**. In the maximum limit provisions of the various public administrations, **contingent risks** in the form of

shareholdings or **loans granted** that may require additional funding or pose default risks were not taken into consideration. The **maximum ESM risk** for the Republic of Austria amounts to **EUR 19.5 billion** (Austria's share of paid-in and callable equity capital).

- In order to more easily assess **cost-benefit relations** of assuming public guarantees and from the point of view of **transparency**, public information on guarantee takers about their business activities and business situation (e.g. business reports) should be required.
- In the **provisions** of the provinces and municipalities on **maximum guarantee limits**, several significant **aspects** are **unregulated or not well specified** (e.g. determining the off-budget legal entities, establishing risk provisions, procedure and sanction mechanisms if the maximum limit is exceeded, coordination procedure on the provincial level). These budget processes should be embedded and harmonized in the **“budget regulations” on the provincial and municipal levels**.
- **Acceptance of guarantee by the government that is both competitive and budget neutral** should have **premiums that are appropriate to the risk**, in order to achieve an internalization of the expected costs. In the Federal Budget Law of 2013 a **premium limit of 1% of the guarantee volume** is standardized, which is likely to be too low for high-risk guarantees. Significantly higher premiums of up to 10% of the guarantee volume were stipulated in the framework of the national Bank Rescue Pact (e.g. asset guarantees) in order to be in line with EU competition law. It seems to be advisable to **evaluate guarantee premiums** as to whether they are budget neutral. There are **no general rules** on guarantee fees on the provincial and municipal levels.
- The **enforceability of the maximum limit for off-budget organizations** is **questionable** on the basis of the present regulations. **Guarantee limits** for off-budget organizations that operate under company law **would be necessary** and additionally would need to be standardized by means of separate resolutions and regulations.
- An **important step** to enabling an **improved assessment** of the risk for public authorities caused by **units with close government ties** would be **obligatory spin-off reports**. These spin-off reports should include comprehensive information on the (budgetary) **interconnectedness among the administrative bodies and their shareholdings** (e.g. statement of payment flows, shareholding relationships, guarantees, debt level, equity capital, etc. for each enterprise). At present only the federal government prepares a spin-off report.
- **In order to avoid miscalculations**, it would be advisable to require a **unified statement of guarantees** of the federal government, provinces and municipalities (at nominal values excluding all interest and costs and/or the present value of claims) in all their publications. In financial terms, the value of guarantees (excluding risk consideration) results from the **actual value** (“market price”) of all outstanding payment flows (capital and interest) at the corresponding reporting date. A list of guarantees **taking into account (accumulation) all interest payments in the actual total guarantees at nominal values** results in an **excessive volume** that would not arise even if a guarantee is asserted by the settlement date.
- Comprehensive contingent risks require **thorough, strategic and ongoing risk management** with **evaluations of the probability of occurrence** and consideration of **system risks**, which can be supported, but not replaced, by laws on maximum guarantee limits. The financial and debt crisis showed that (explicit and implicit) liabilities may become reality unexpectedly and on a large scale and spillover effects may also come to bear.
- The **requirement profile** for such comprehensive **risk management** should be suited to the amount and degree of complexity of the portfolio and should keep the administrative effort as low as possible. Instruments like stress testing and scenario analyses would be suitable options.

On the whole, uniform minimum standards (for the federal government, provinces, and collectively for municipalities in each province) seem appropriate:

- On the federal level the **Federal Budget Law 2013** and the **Federal Maximum Guarantee Limitation Act** standardize approaches for risk management (information and registration requirements of the debtor, maximum guarantee limits, managerial accounting, creating guarantee provisions if the probability of default is more than 50% etc.). These approaches **could be further developed (strategic risk management throughout the whole federal level)**.
- On the provincial and municipal levels, **budget rules** that determine detailed budget processes and competences **have so far hardly been passed** or if so they are **very rudimentary**. For these levels it would still be necessary to set **risk management standards** by law.