August 2002
IMF Country Report No. 02/184

Austria: 2002 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Austria

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with Austria, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **May 6, 2002,** with the officials of Austria on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 10, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its August 8, 2002 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Austria.

The document(s) listed below have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

AUSTRIA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the
2002 Consultation with Austria

Approved by Ajai Chopra and M. T. Hadjimichael

July 10, 2002

The 2002 Article IV consultation discussions were held in Vienna during April 24-May 6, 2002. The mission comprised Mr. Demekas (head), Mr. Eskesen, and Ms. Krajnyák (all EU1), and Mr. Andrews (MAE). Mr. Prader, Alternate Executive Director for Austria, participated in the discussions. The mission met the Ministers of Finance, Economic Affairs and Labor, and Social Affairs; the Governor of the Austrian National Bank (OeNB); members of the parliamentary budget and finance committees; officials of the federal government, the OeNB, and the Financial Market Authority; the federation of trade unions; and representatives from the subnational governments, the chamber of commerce, the banking sector, the academic community, and the main economic research institutes.

Parliamentary elections are to take place no later than October 2003. The authorities released the mission's concluding statement and have agreed to the publication of the staff report.

The last Article IV consultation was concluded on June 11, 2001. Directors commended the authorities for their record of strong growth, falling unemployment, and low inflation, welcomed the recent fiscal policy correction and steps to liberalize utilities, recommended a longer-term focus in the fiscal policy debate, and urged the authorities to implement their unfinished structural agenda.

Austria has accepted the obligations of Article VIII (Appendix I), and subscribes to the Fund's Special Data Dissemination Standard (Appendix II). Data in this report reflect information received by June 28, 2002. More recent data can be obtained directly from the following sources:

Austrian Institute of Economic Research (WIFO) .... http://www.wifo.ac.at/
Austrian National Bank .... http://www.oenb.co.at/
Federal Ministry of Finance .... http://www.bmf.gv.at/
Institute of Advanced Studies (IHS) .... http://www.ihs.ac.at/
Statistik Austria .... http://www.oestat.gv.at/
Eurostat... http://www.europa.eu.int/comm/eurostat
Information and documentation on Austrian economic
statistics can also be found at the Special Data
Dissemination Standard website of the IMF .... http://dsbb.imf.org/country.htm

Contents Page

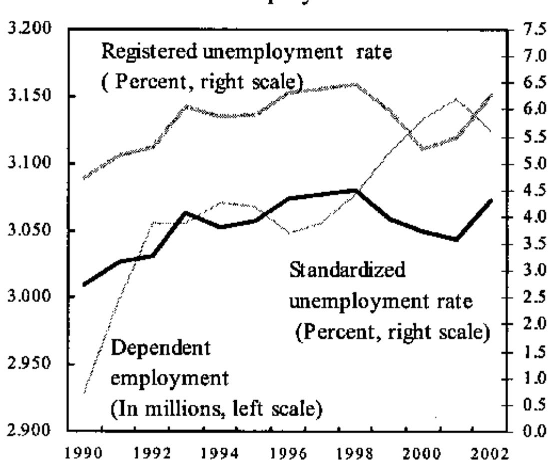
I. Economic Background

1. ***Economic performance in the 1990s was good but policies in several areas remained unambitious.*** Growth was comparable to the average of the EU and inflation and unemployment among the lowest (Figure 1), the latter largely due to a tradition of wage moderation. However, fiscal policy was allowed to drift (except for a spurt of adjustment in 1996-97) leading to a rising public debt, and there was little effort to address the growing long-term imbalance of the pension system or the pervasive role of the state in the economy.

2. ***After eight years of solid growth, the Austrian economy slowed sharply in 2001.*** Consumption growth declined as in the rest of the EU and investment fell driven mainly by a drop in residential construction, reflecting a structural break after years of sustained growth. Despite a deceleration, exports grew 4.5 percent in real terms, and net exports were a strong contributor to GDP growth, which averaged 1 percent in 2001.

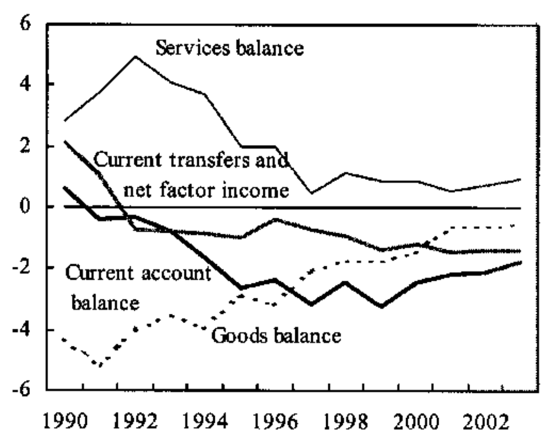
3. ***The overall macroeconomic situation remained balanced.*** The labor market effects of the slowdown have so far been limited: although unemployment ticked up to around 4 percent (Figure 2), it is still one of the lowest in Europe, and wage increases remain moderate. After topping 2 percent in 2001 on account of one-off factors (the introduction of tuition fees, outpatient copayments, and an increase in road usage fees) and second round effects from earlier oil price increases, inflation subsided in early 2002 and is once again below the euro area average. The OeNB estimates no price effects from the euro changeover. Competitiveness remained strong, reflecting continued wage moderation and cumulative productivity gains from the industrial restructuring of the 1990s. As a result, the current account deficit narrowed to 2.2 percent of GDP in 2001, where it is expected also to remain this year (Figures 3 and 4).

Figure 2. Austria: Employment and Unemployment



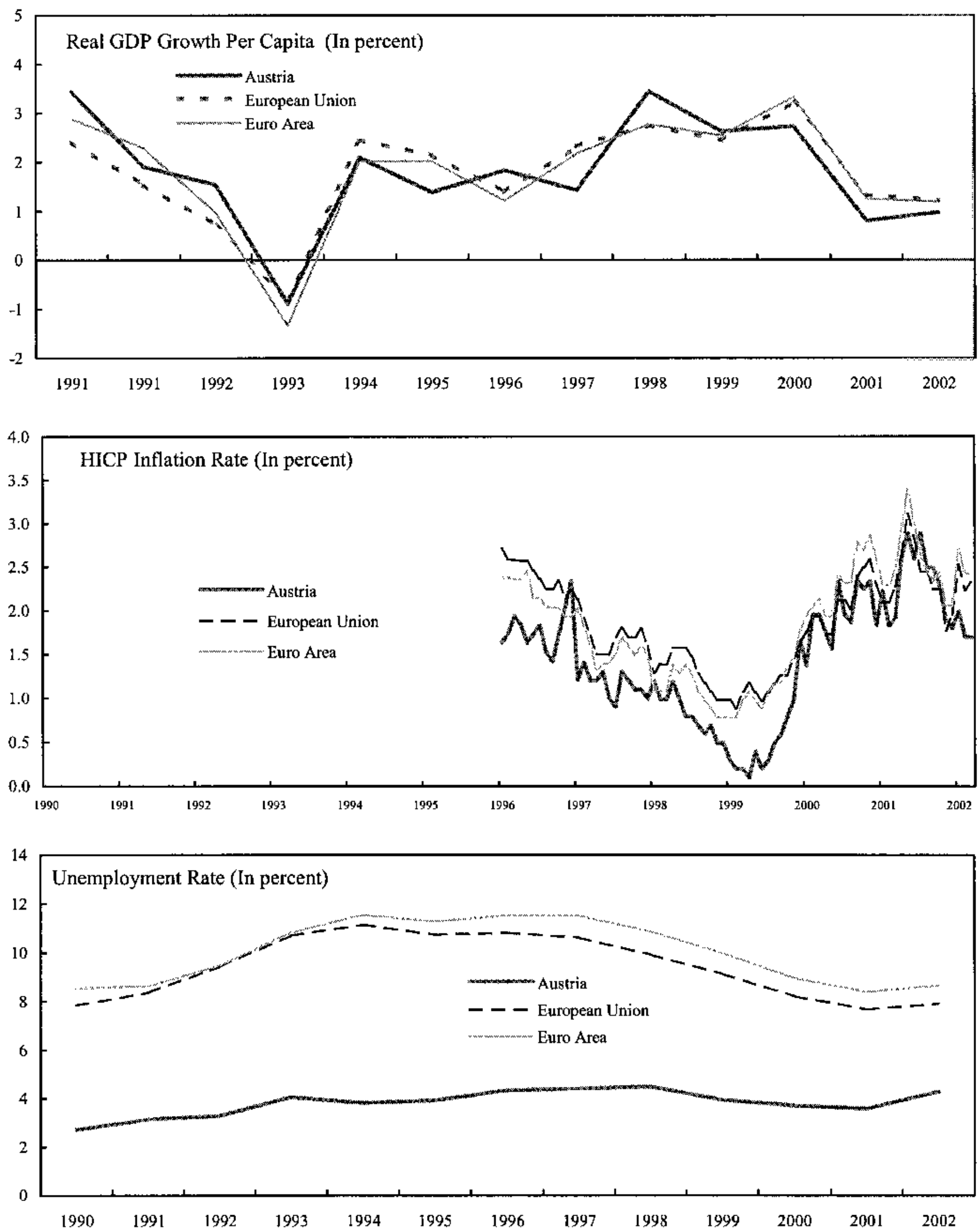
Source: IMF, World Economic Outlook.

Figure 3. Austria: Components of Current Account (In percent of GDP)



Source: IMF, World Economic Outlook.

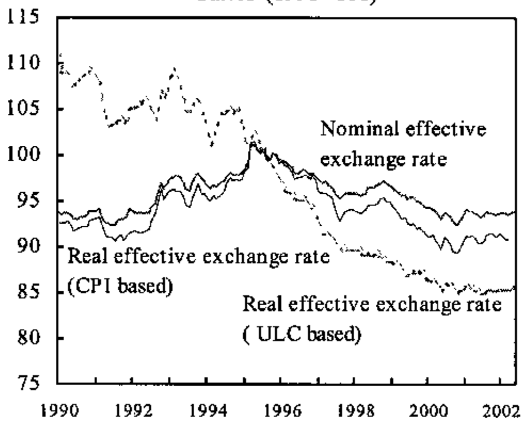
Figure 1. Austria and European Union: Output, Inflation, and Unemployment



Source: IMF, World Economic Outlook; and Eurostat.

4. ***After years of unambitious fiscal policies, there was a major shift in 2001-02 toward the objective of balancing the general government budget.*** By 2000, the share of the general government spending and deficit to GDP were among the highest in the euro area. Austria's 2000 revision of its Stability Program (Box 1), followed by the 2001-02 federal budgets and combined with an "internal stability pact" between the federal, provincial, and local governments, aimed at a moderate fiscal withdrawal in both years to shrink the general government deficit to ¾ percent of GDP in 2001 and to nil in 2002.

Figure 4. Austria: Effective Exchange Rates (1995=100)



Source: IMF, International Financial Statistics.

5. ***In the event, general government balance was reached already in 2001, a year ahead of schedule.*** Cautious budgeting on the revenue side, larger-than-expected effects from the tax measures of the adjustment program, and strict expenditure discipline resulted in a better-than-expected budget outcome despite the weakening of economic growth. The negative cyclical impact on revenue was more than offset by a windfall from accelerated corporate tax payments following higher penalties on late payments (½ percent of GDP); stronger-than-expected permanent effects of the 2001 tax package (0.2 percent of GDP); and other one-off events (such as higher dividends from the OeNB). As a result, revenues outperformed the budget by about ¾ percent of GDP, while aggregate expenditures remained on target.[1]

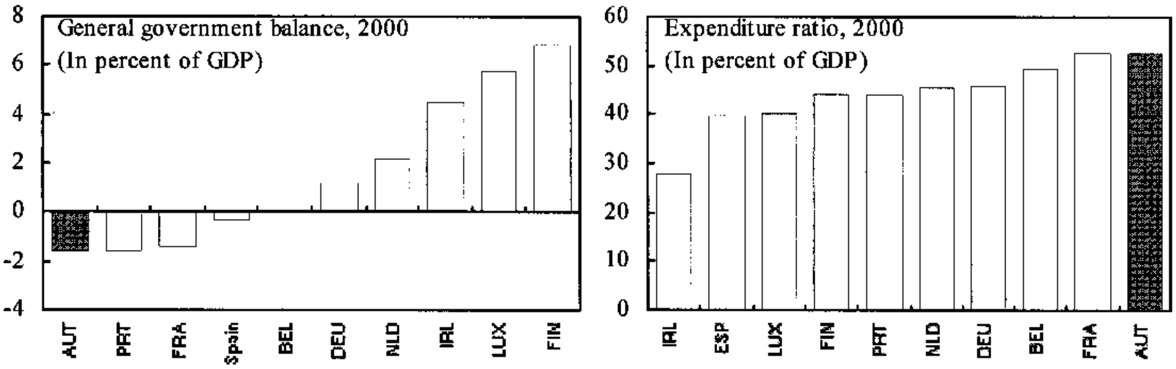
6. ***The effects of the fiscal contraction in 2001 were partly offset by easier monetary conditions.*** Fiscal adjustment is estimated to have imparted a fiscal withdrawal of about 2 percentage points of GDP (as measured by the change in the primary structural deficit excluding one-off effects), while the ECB rate cuts and a broadly stable real exchange rate resulted in easier monetary conditions (Table 2 and Figure 5).[2]

[1] At the time of the discussions, the 2001 deficit had not yet been certified by Eurostat due to differences in the interpretation of rules on the treatment of the one-off tax revenues.

[2] Monetary policy transmission in Austria tends to operate mainly through the balance sheet channel, while wealth effects are weak (for more detail see OeNB (2001), *Aspects of the Transmission of Monetary Policy*, Vienna).

Box 1. Austria's Stability Program

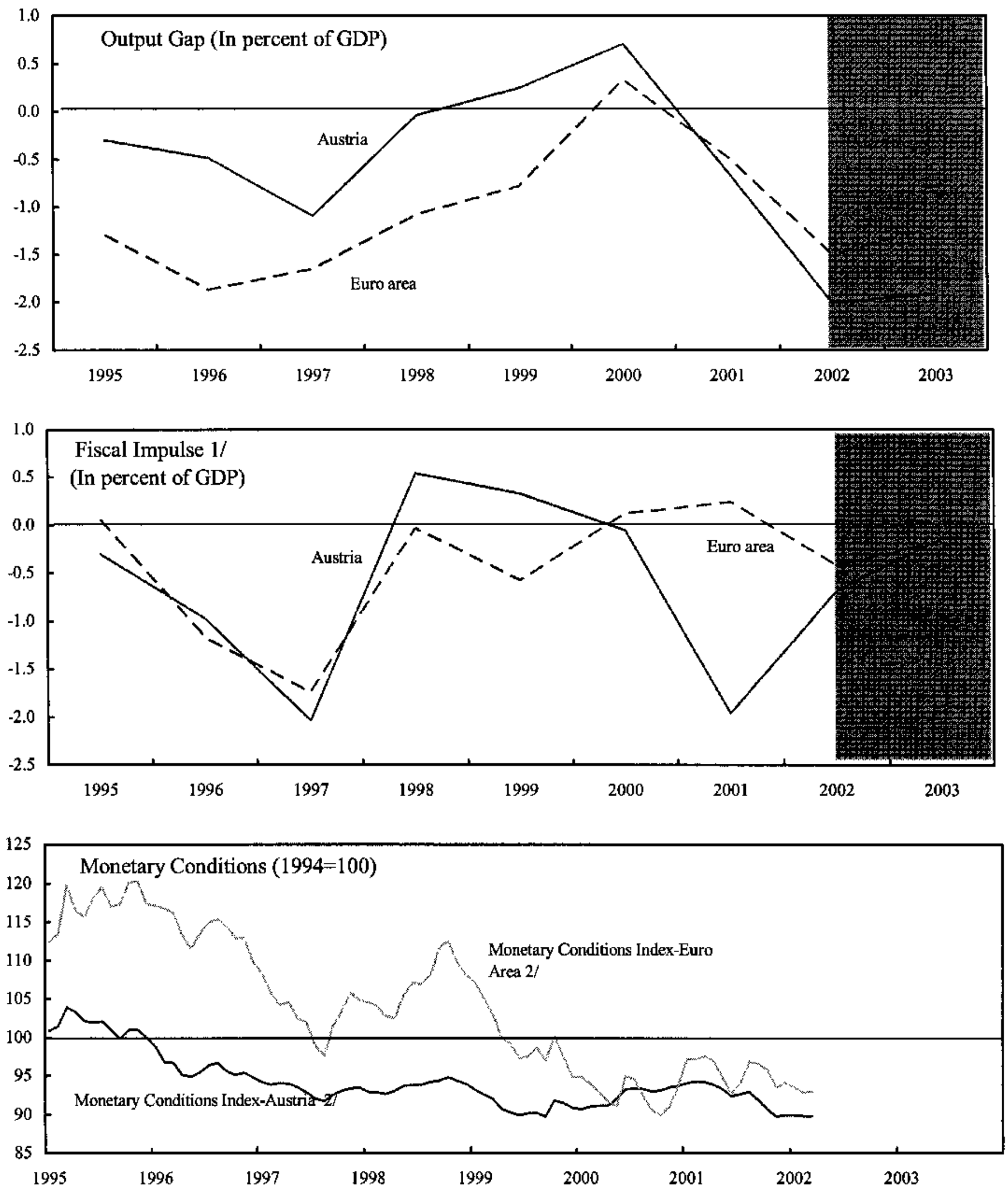
After years of fiscal policy drift, the authorities' **Stability Program for 2000-04** set the goal of reaching "zero deficit" in 2002 and maintaining it thereafter over the cycle (the 2000-04 Stability Program was presented in SM/01/157). The adjustment effort planned for the first two years of this period combined a tax package (expected at the time to generate revenues of 1 percent of GDP) with savings on administrative expenditures and the public sector wage bill. It also relied on annual surpluses of about ¾ percent of GDP by the subnational governments, an improvement of about 0.4 percent of GDP over their position in 2000. This was set out in an "internal stability pact" between the federal and the provincial and local governments for the same period.



The policy of fiscal prudence, embodied by the "zero deficit" objective, gained strong public support and, due partly to one-off revenues, the general government budget was balanced already in 2001. The ***latest update of the Stability Program***, covering the period 2001-05, reaffirms the medium-term objective of maintaining a balanced budget over the cycle, and envisages completing the adjustment effort in 2002 and keeping the fiscal position unchanged on a cyclically adjusted basis in 2003-04. A further small improvement in the structural balance is projected for 2005.

7. ***In recent years, the policy focus has shifted toward addressing the longer-term implications of the changing global and domestic environment.*** There has been a growing realization that Austria is faced with two major long-term challenges: globalization—notably a rapidly integrating (and soon expanding) Europe—which implies stronger competition and higher institutional and policy standards; and the effect of demographic trends. In response, fiscal policy is increasingly focused on medium-term goals; the prudential framework for the financial sector is being modernized; and there is a new impetus behind policies to liberalize markets, divest state holdings, and decrease the economy's regulatory burden.

Figure 5. Austria: Output Gap, Fiscal Impulse, and Monetary Conditions



Sources: IMF, World Economic Outlook; International Finance Statistics; and staff estimates.

1/ Change in structural primary balance; adjusted for sale of mobile phone licenses and real estate and net subsidized lending.

2/ Weighted average of real short-term interest rates and real effective exchange rate (weights: 3 and 1, respectively).

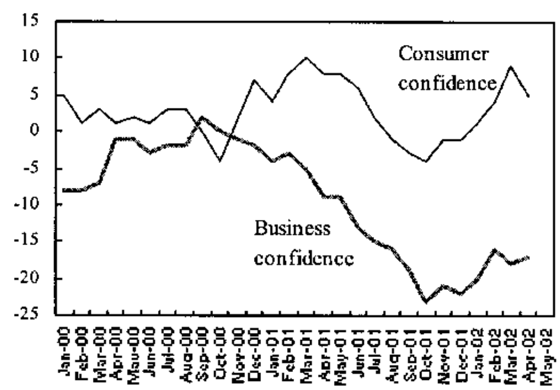
II. Report on the Discussions

8. ***The discussions focused on the short-term outlook and policies, medium-term fiscal plans, and financial sector and structural issues.*** The discussions took place against the background of increasing economic and financial integration within the European Union, as well as between Austria and the neighboring Central and Eastern European countries (CEECs) (Box 2).

A. Short-Term Outlook and Policies

9. ***Staff projects the economic upswing to gather speed gradually during 2002.*** With growth slowly picking up to above potential in the second half of the year, the economy is projected to expand by 1 percent in 2002 and 2½ percent in 2003, led by a recovery in fixed investment and an acceleration of export growth in line with foreign demand. Unemployment is expected to decline below 4 percent, and inflation to ease further. This outlook is less upbeat than the earlier projections underlying the original 2002 budget, which envisaged a faster recovery, but broadly in line with the authorities' latest projections. It is also consistent with confidence indicators that point to a gradual strengthening in activity starting in early 2002 (Figure 6).

Figure 6. Austria: Confidence Indicators, 2000-2002



Source: Eurostat.

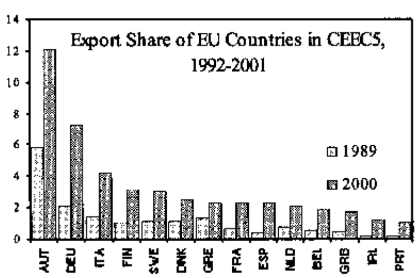
10. ***Projecting a turning point in the cycle is, of course, fraught with uncertainty; but the risks appear broadly balanced.*** Expectations of a gradual recovery in the second half of 2002 are based on preliminary first quarter data suggesting that activity has bottomed out and business and consumer confidence indicators. The major downside risk now is a protracted malaise in the rest of the EU for most of this year, with possible knock-on effects on domestic investor confidence. In such a case, growth for 2002 could fall below last year's 1 percent average. In contrast, a sharp appreciation of the euro does not represent a major risk, as about three-quarters of Austria's trade is with the EU or CEECs. On the other hand, a stronger-than-expected recovery in Europe or a rebound in consumption growth could boost average growth to above 1 percent in 2002.

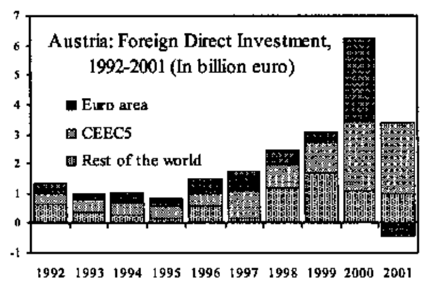
Box 2. Austria and EU Enlargement

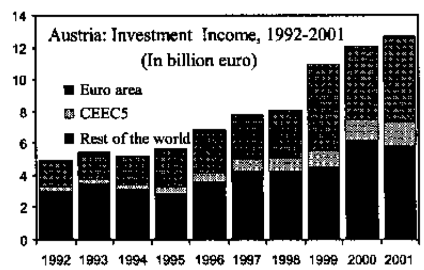
Four of Austria's eight neighbors—the Czech Republic, Hungary, the Slovak Republic, and Slovenia—covering almost half of Austria's borders, are currently candidates for EU entry. The economic importance of the candidate countries is significantly higher for Austria than for any other EU country. Consequently, Austria is likely to be among the EU members where the economic effects of enlargement would be relatively strongly felt. This Box summarizes the findings of research on the likely economic impact of enlargement on Austria, which are discussed in more detail in an accompanying Selected Issues paper.

During the 1990s, Austria built strong economic links with the CEECs and benefited in the process, taking advantage of proximity, historical ties, and the fast re-integration of CEECs into the European economy.

- The restructuring CEECs provided new markets for Austrian producers. Export growth averaged over 10 percent a year in the past decade, and the CEECs now account for 12 percent of Austrian exports.
- Austrian firms have exploited favorable investment opportunities in CEECs. The CEECs' share in Austrian outward foreign direct investment has quickly reached that of the euro area, and Austria is now among the top three foreign direct investors in its CEEC neighbors. Investment income from these countries has grown, and the Austrian firms' ability to outsource (both in manufacturing and services) to firms in the east has helped cut costs and improve profitability and competitiveness.
- Studies show that the impact on employment has been positive: a net of 20,000 to 40,000 jobs are estimated to have been created in manufacturing as a result of Austria's success in exploring business opportunities in these markets.







Source: OeNB; and IMF Direction of Trade Statistics.

EU enlargement will generate similar benefits: trade creation from the elimination of border controls, productivity gains from economies of scale, and lower markups from stronger competition, boosting output and dampening inflation. Few question these benefits. However, there are popular concerns regarding the potential budgetary costs, as well as the effects of factor movements, especially migration. There is little that can be said about the former, since post-accession budgetary arrangements are still being negotiated. As regards the latter:

- While the estimated scope for immigration is highly uncertain, the experience from previous EU enlargements and the German unification suggests that fears of cheap labor from the East inundating the Austrian labor market are unfounded.
- Distributional effects, however, are likely to materialize. The increasing integration of the border regions' labor markets via, e.g., commuting could shift the skill composition of the labor force and change relative wages, with the high-skill workers the likely winners and low-skill workers the losers. Patterns of regional comparative advantage are already changing and production locations shifting as the CEECs reclaim their place in the European economy. This process could speed up after EU enlargement, and Austrian regions currently specializing in industries that rely on lower-skilled labor could be adversely affected.
- While the seven-year transitional arrangement limiting labor mobility for accession countries should assuage concerns about labor market stress, increasing the economy's flexibility remains the best strategy to ensure that temporary adjustment pains are minimized and Austria benefits to the full potential from enlargement.

Where can we draw the balance? The conclusion seems to be that Austria stands to win from enlargement and, although modest, the gains are the largest among current EU members. Enlargement is an opportunity with potential benefits that the Austrian economy is well-placed to exploit.

11. ***The authorities intended to stick to the previously mapped out fiscal adjustment path, which they considered key for the credibility of their policies.*** Earlier in the year, the Ministry of Finance expected general government balance in 2002. In June 2002, after the consultation discussions, the Ministry of Finance indicated that, due to the slower-than-expected recovery, tax revenues would be lower, resulting in a general government deficit of 0.3-0.4 percent of GDP in 2002. Nonetheless, the government intended to stick to the planned adjustment path, neither relaxing the fiscal stance nor taking additional contractionary measures. Instead, measures already in the pipeline would be fully implemented, notably in the areas of public employment, pensions, and administrative expenses. However, uncertainties remained regarding the contribution by subnational governments. It was unclear how the *Länder* and *Gemeinde* planned to substitute in 2002 for their share of the one-off revenues last year so as to maintain the planned surplus of ¾ percent of GDP.

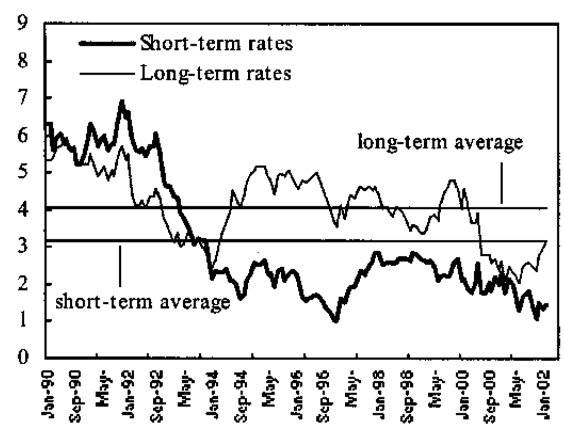
12. ***The stance of fiscal policy was considered to be moderately restrictive in 2002.*** Fiscal adjustment would continue, with permanent measures on the expenditure side replacing the one-off revenues of 2001, but the additional fiscal withdrawal would be relatively modest (estimated by the staff at 0.7 percent of GDP in 2002). The authorities argued that aggregate measures of the fiscal stance exaggerated the contractionary effects of their policy. If the composition of the adjustment was taken into consideration, the impact on the real economy would be smaller: for instance, savings on pensions from increasing the early retirement age were more likely to stimulate activity via higher employment. In addition, monetary conditions remained appropriately supportive (Figure 7), mitigating the effects of the tight fiscal policy given Austria's negative output gap and low inflation.

Indicators of Fiscal Policy
(In percent of GDP)

	2001	2002	2003
General government balance	-0.1	-0.5	-0.2
Structural balance	-0.8	0.0	0.3
Fiscal impulse	-2.0	-0.7	-0.1

Source: IMF staff estimates.

Figure 7. Austria: Real Interest Rates, 1990-2002



Sources: WEFA database; Bloomberg; and staff calculations.

13. ***The mission agreed that the credibility benefit from staying the course was likely to outweigh short-term costs.*** Although the fiscal adjustment coincided with a period of slower growth, the medium-term benefits from establishing a track record of fiscal prudence were likely to be significant, especially given Austria's performance during the 1990s. The mission thus supported the authorities' intention to stick to the planned fiscal adjustment in 2002.

B. Fiscal Policy in 2003

14. ***Fiscal policy plans for 2003 were shaped by potentially conflicting objectives.*** On one hand, the government was committed to Austria's Stability Program objective of maintaining a balanced budget over the cycle, capitalizing on the adjustment effort of 2001-02. On the other hand, it saw the 2003 budget as an opportunity to start delivering on its pledge to lower significantly Austria's high tax burden over the medium term (see below) by implementing a tax reduction package. At the time of the discussions, there was no decision on the size of this package or its components (although reductions in non-wage labor costs and income taxes were emerging as strong contenders). But the authorities acknowledged that to reconcile their two objectives, savings on the expenditure side would be necessary.

15. ***The authorities and the mission agreed that a relaxation of the fiscal stance in 2003 would not be desirable.*** The mission pointed out that a substantial deviation from the policy of balanced budget over the cycle due to unfunded tax cuts in 2003 would deal a large blow to the credibility of Austria's Stability Program. Because such a policy relaxation would coincide with the electoral cycle, it would be seen as a return to the "stop-go" cycles of the past, with large pre-election increases in the deficit followed by mid-tenure corrections, and call into question the recent shift towards a longer-term policy focus. The authorities took a longer-term view, pointing out that the beneficial effects of a tax reduction on the supply side would be spread over several years. They nevertheless agreed that sizable unfunded tax cuts or accommodation of pent-up spending pressures ahead of the elections could be seen as backtracking on the hard-won 2001-02 fiscal adjustment.

C. Medium- and Long-Term Fiscal Issues

16. ***A major new goal of the government is to reduce Austria's tax burden to 40 percent of GDP by 2010.*** This very ambitious goal (implying a tax reduction of some 6 percentage points of GDP) is a key element of the government's strategy to liberalize the economy, reduce the role of the state, and strengthen the private sector. Austria's current high tax burden (among the highest in the EU) and attendant distortions were seen as impediments to the achievement of these objectives. Moreover, in an environment of increasing international factor mobility, high tax rates would undermine Austria's competitiveness and erode the tax base.

17. ***The authorities and the mission agreed that achieving this goal required rethinking the economic role of the state.*** Lasting tax reductions of this magnitude required overhauling not only the size and structure of government revenue, but also that of expenditures. Given the importance of the Stability Program's medium-term deficit objective, finding expenditure cuts to match the planned tax reductions was the first priority. But the mission and authorities agreed that the quality of the expenditure adjustment would be at least as important as the

quantity.[3] The mission also stressed that the tax reform should aim at minimizing distortions and disincentives to work and reducing the burden on labor and capital.

18. ***Ongoing reforms of civil service and public administration could contribute to savings on the expenditure side but were unlikely by themselves to generate sufficient room for the desired tax reduction***. The authorities' current efforts focused on reducing the number of civil servants and achieving savings on operating costs at all levels of government. Further savings could be realized from implementing the Expenditure Reform Commission's recommendations.[4] These measures alone, however, could not generate the required aggregate savings without reform of entitlements, which were the bulk of total spending.

19. ***The mission argued that adopting a comprehensive medium-term fiscal framework would help the implementation of the authorities' plans***. A coherent and transparent medium-term framework would help ensure consistency of the objectives, highlight policy tradeoffs—between tax cuts and public spending, and between competing expenditure categories—and thus provide a basis for informed and rational political choices. It would also help lengthen the policy horizon and build political consensus and public support for the key objectives. In particular, medium-term expenditure targets broken down annually, as well as by category, could constitute a "road map" towards the objective of a smaller government, both quantitatively and qualitatively, spelling out structural shifts in public spending. The authorities concurred that such a medium-term fiscal policy framework would be a useful tool. They noted that the new budget framework law currently under preparation would pave the way toward developing and adopting one.

20. ***The mission emphasized that a longer-term focus in fiscal policy design was required also in light of Austria's demographic trends***. Austria's age composition was expected to worsen in line with the EU average and the old-age dependency ratio to double by 2050. Although the pay-as-you-go public pension system already was one of the most expensive in the developed world (14½ percent of GDP), Austria's preparations for the

---

[3] In this connection, the mission noted with interest a new analytical tool developed at the Ministry of Finance for classifying public outlays according to their time dimension (past-, present-, or future-related). This classification provided useful insights into the structure of public spending and could be used for evaluating alternative savings measures. For a detailed exposition, see Katterl, A. (2002), "On the time dimension of fiscal policy", mimeo, Ministry of Finance, as well as an annex to the Selected Issues paper accompanying this report.

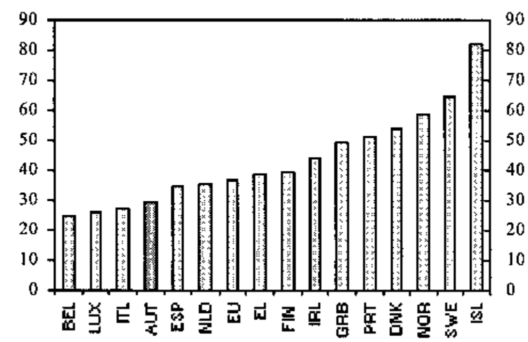
[4] The Commission's mandate was to identify administrative overlaps and areas where government involvement was no longer warranted. Its March 2001 report recommended, inter alia, rationalizing of the system of intergovernmental transfers, closing or merging certain government offices and agencies, changing school and hospital administration and financing, abolishing non-means-tested housing subsidies, and privatizing real estate and forest holdings.

effects of demographic changes on public finances were not well advanced. Recent measures (notably a phased-in increase in the minimum early retirement age by 1.5 years and a gradual harmonization of female and male retirement ages scheduled to take place from 2019 to 2033) were insufficient to address the prospective financial imbalance of the system.

21. ***The outlook for age-related spending was a focal point of the discussions.***[5] The authorities' projections indicated that demographic changes would generate considerable fiscal stress over the longer run, with age-related spending peaking around 2035 at about 6 percentage points of GDP higher than today. Of this increment, over 4 percentage points were due to higher pension expenditures. In view of this outlook, the authorities set up a commission to study reform proposals. However, public awareness of the problem was low (partly because demographic trends will not worsen noticeably in the next few years) and the possibility of additional measures being implemented in this legislative period remote.

22. ***The mission noted the risks to the authorities' age-related spending projections, and stressed that reforms of the pension system were urgently needed to reduce threats to long-term fiscal sustainability.*** In the mission's view, the authorities' projections were based on rather optimistic assumptions regarding future trends in labor market participation. Given Austria's low current rate of labor force participation (Figure 8) and the rising weight of the older cohorts in working age population, the strong increase in the overall participation rate envisaged in the authorities' projections implicitly assumed a substantial voluntary rise in the retirement age. Under less optimistic assumptions, staff projections showed that age-related spending would peak more than 9 percentage points of GDP above current levels, with pensions contributing 6 percentage points (Figure 9). Another risk to the authorities' projections was the possibility of higher cost inflation in the health and long-term care sectors. As age-related demand for these services was likely to lead to relative price increases, cost pressures could be higher than envisaged in the authorities' projections. Given these risks, the mission stressed the importance of early and decisive pension reforms to safeguard long-term fiscal sustainability. Staff pointed out that policy options essentially boiled down to two: lengthening working life, or reducing benefits. Given Austrians' relatively short working life, priority should be given to the first option. The

Figure 8. Cross Country Comparison of Labor Force Participation Rate, 55-64 Cohort, 1999

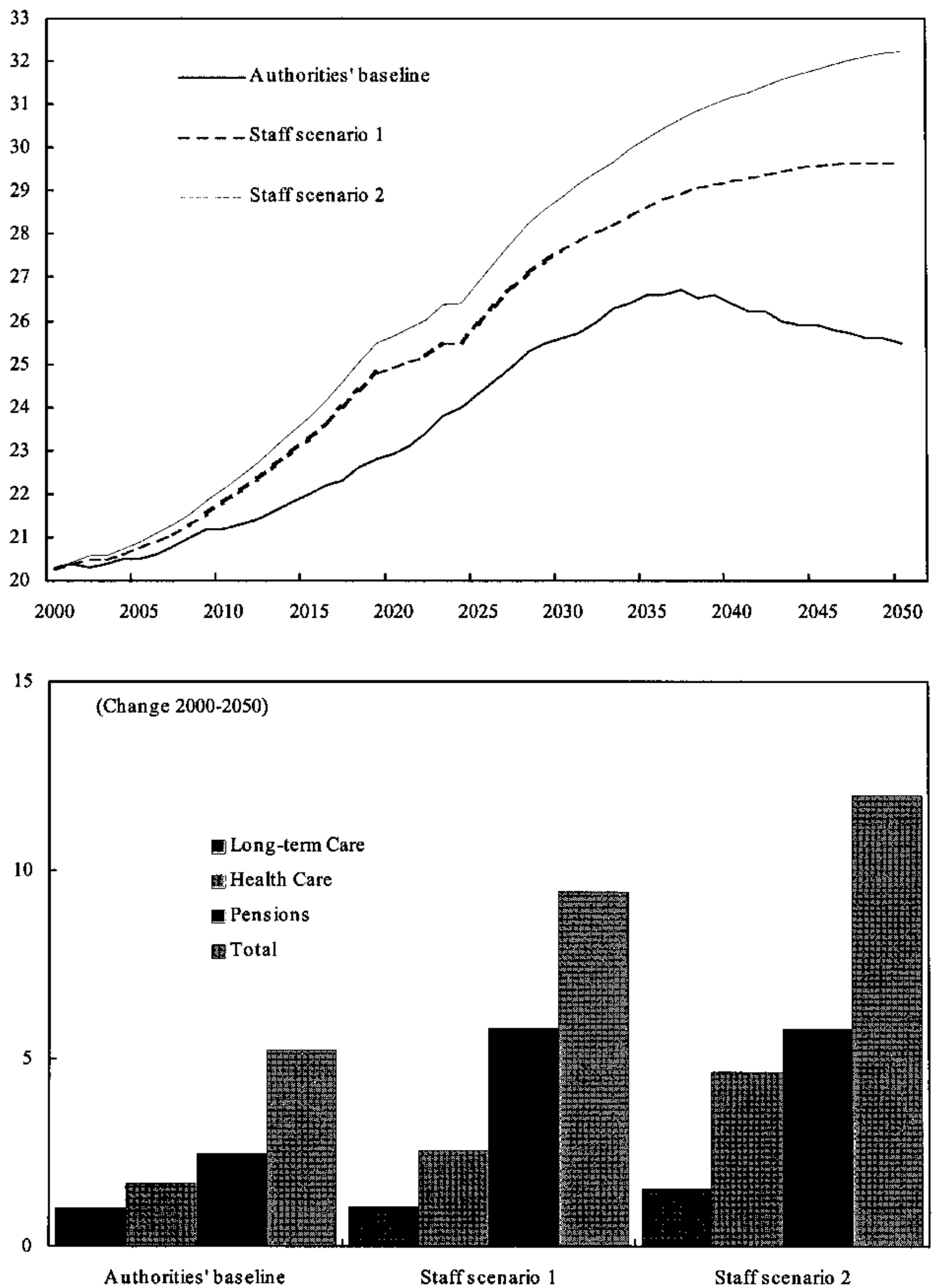


Source: Eurostat.

[5] An accompanying Selected Issues paper presents the staff's analysis of the long-run sustainability of the public finances in light of demographic trends.

mission also warned against the risk of complacency arising from a myopic view of demographic trends and a reluctance to undertake painful adjustment measures.

Figure 9. Austria: Total Age-Related Spending, 2000-2050 1/
(In percent of GDP)

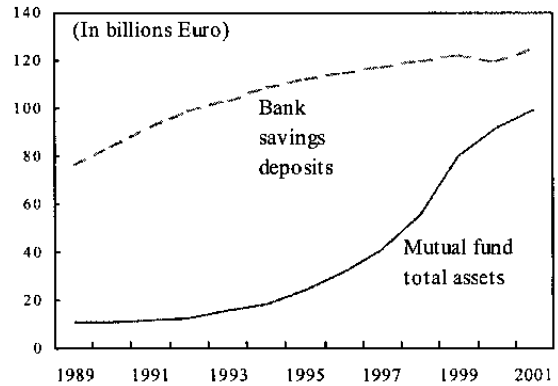


Sources: Ministry of Social Affairs; and staff projections.
1/ Staff scenario 1 assumes a smaller increase in participation rates. Staff scenario 2 assumes additional demand-induced cost increases in health and long-term care.

D. Financial Sector Issues

23. ***The Austrian financial sector and its supervisory structures were adapting to changing consumer preferences and globalization.*** Like investors in other developed economies, Austrian savers were demonstrating an increased preference for other instruments over traditional savings deposits (Figure 10). Meanwhile, the Austrian financial system was becoming increasingly internationally oriented. These changes, combined with evolving international standards, triggered an adaptation of supervisory structures and practices, and a renewed drive to monitor and research systemic issues (notably in the OeNB's semiannual *Financial Market Stability Report*).

Figure 10. Austria: Bank Savings Deposits and Mutual Fund Assets, 1989-2001

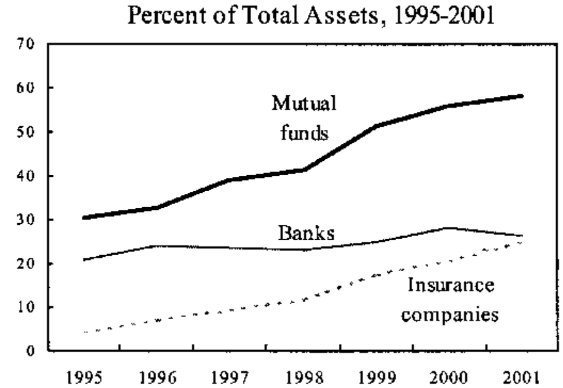


Source: OeNB.

24. ***In the authorities' assessment, opportunities from the increasing international orientation of the Austrian banking system outweighed additional risks.*** The most visible aspect was the Austrian banks' expansion in CEECs. Investment in their CEEC subsidiaries amounted to 10 percent of Austrian banks' assets at end-2001, but contributed one-third of their profits. Margins in the CEECs had consistently been higher, and loan-losses lower, than in the mature banking markets of Austria. This was attributed to two factors: the banks' prudent approach to credit risk in the CEECs, evidenced by slow credit growth and an initial focus on only well-established borrowers; and the guarantees and put options obtained when investing in formerly state-owned banks. Overall, the Austrian banking system continued to report satisfactory earnings (2001 ROE of 9.8 percent), albeit at the lower end of the range of banks in the EU. Solid capitalization (14.6 percent of risk-weighted assets at end-2001) and conservative provisioning (120 percent of non-performing loans at end-2000) mitigated the lack of resilience to credit losses implicit in low earnings capacity. On the whole, the authorities identified no specific vulnerabilities or areas of systemic concern and considered the financial sector fundamentally sound.

25. ***The outward expansion of Austrian banking groups was paralleled by the increasing international activities of the financial sector's other segments.*** For the pension, insurance, and mutual funds, the small size of the Austrian capital markets virtually forced a dynamic outward expansion (Figure 11) as their assets continued to grow. With the free float of shares on the Vienna Stock Exchange at only 40 percent of market

Figure 11. Austria: Foreign Assets as a Percent of Total Assets, 1995-2001



Source: OeNB.

capitalization (or about 5 percent of GDP compared with about 30 percent in the rest of the EU) and a small bond market (about 75 percent of GDP at end-2000), the demand for capital market instruments far exceeded domestic supply.

26. ***The establishment of a supervisory agency with full legal independence was a major step in strengthening and modernizing the prudential framework.*** The authorities established a single agency with responsibility for banks, insurance companies, capital markets and pension funds, but retained a significant role for the OeNB in bank supervision. The Financial Market Authority (FMA) began operations on April 1, 2002, after a constitutional provision secured its statutory independence. The legislation mandated cooperation and coordination between the FMA and the OeNB, with the latter continuing to conduct on-site examinations focusing on credit and market risk. Both the FMA and OeNB were expanding their supervisory capacity, with a view to examining all banks on-site on a periodic basis.[6] Reflecting the relatively large exposure of Austrian banks to the CEECs, memoranda of understanding had been concluded with the supervisory authorities in the Czech Republic, Hungary, and Slovenia, and were being negotiated with Slovakia and Poland. The FMA and the OeNB were planning to begin on-site examinations of the Austrian banks' foreign establishments in the second half of 2002.

27. ***In addition, the authorities noted that revisions to the Banking Act and to regulations had helped strengthen the supervisory framework.*** Recent revisions to the Banking Act specified extensive new requirements with respect to market risks and internal models. Prudential reporting requirements had been enhanced, expanding the coverage and/or increasing the frequency of reporting on key risks, and a new directive for supervision of conglomerates was in preparation. In the area of anti-money laundering, measures had been implemented to address concerns regarding the potential abuse of anonymous passbook accounts: revisions to the Banking Act now prohibited opening accounts without appropriate identification of the customer and, effective end-June 2002, eliminated the possibility of anonymous deposits or withdrawals. On this basis, the authorities considered Austria fully compliant with all the Financial Action Task Force recommendations. Finally, the authorities reiterated their interest in an FSAP in 2003 or 2004, with a view of taking stock of financial sector reforms to date and identifying future priority areas.

E. Structural Issues

28. ***The authorities continued to place emphasis on microeconomic reforms to increase efficiency and the growth potential, but progress remained uneven.***

---

[6] In addition to the approximately 100 staff transferred from the Ministry of Finance and the Austrian Securities Authority, the FMA planned to recruit and train about 50 new staff, primarily for its bank examination department. The OeNB was also increasing its bank examination resources.

- The first phase of the authorities' privatization program had been completed; however, there were no signs that the second phase was about to begin.

- The opening of the gas and electricity markets proceeded according to plans and was set to be completed well ahead of EU deadlines, with the electricity market fully liberalized in October 2001, and the gas market in October 2002.

- An independent, unified Competition Authority had been established, with the power to initiate and investigate cases. Decisions would remain vested with the Cartel Court.

- Recent legislation streamlined regulatory and administrative requirements on business by, inter alia, partially liberalizing access to professions, introducing the one-stop-shop administrative principle for setting up business, allowing electronic registration, and reducing set-up costs. However, the liberalization of shop opening hours had stalled.

- In the labor market, the planned reform of the severance payment system, which envisaged universal entitlement and full portability of benefits, would contribute to greater flexibility. The mission noted, however, that recent measures in other areas could have adverse labor market effects: enhanced family benefits could reduce parent's incentives to participate in the labor market, and the part-time retirement scheme could promote earlier, rather than later, retirement.

- There was no progress with implementing the recommendations of the Expenditure Reform Commission in areas such as housing subsidies, education, or hospital management.

29. ***The mission underscored the importance of structural reforms for long-term productivity growth.*** They would help maintain Austria's position in an increasingly competitive environment and raise the economy's potential growth. In this way, they would also contribute to some extent toward accommodating the growing burden of age-related spending.

III. Staff Appraisal

30. ***The Austrian economy is coping well with the economic slowdown.*** Although growth weakened considerably in 2001, the outlook is projected to improve, against the background of strong competitiveness and supportive monetary conditions. Growth is expected to pick up again in the second half of 2002 and unemployment and inflation to remain low.

31. ***Economic policy in recent years has delivered some notable successes.*** Recognizing the need for a fiscal correction, the authorities set general government balance as their medium-term fiscal objective, managed to rally public support for the "zero deficit" target,

and implemented the necessary adjustment measures, taking an important step toward sound public finances. An independent financial supervisory authority was established to strengthen and modernize the supervisory framework. Microeconomic reforms gained new momentum: the first phase of the privatization program was completed, a new competition authority was established, deregulation of network industries advanced, and measures were taken to improve the efficiency of the public sector and the environment for business. What these policies have in common is a medium-term orientation, aimed at enhancing the flexibility and resilience of the Austrian economy.

32. ***The policy focus on medium- and long-term objectives should be sustained and strengthened.*** A strategic approach to policy design would help secure continued growth with stability. More concretely, such an approach would provide the appropriate framework for the economy to meet the longer-term challenges of globalization and population ageing.

33. ***Fiscal prudence should be maintained.*** Setting the objective to keep the general government budget balanced over the cycle and implementing the measures needed to reach this objective were major milestones toward ensuring responsible fiscal management. Fiscal policy should now stay firmly on this track. In particular, a relaxation of the fiscal stance in 2003, either because of electoral considerations or because of perceived conflicts with other medium-term objectives, such as tax reform, would jeopardize these achievements and raise questions about Austria's commitment to its own Stability Program.

34. ***The strategic goal to reduce the tax burden over the medium term is appropriate.*** A high tax burden relative to other advanced economies would prove increasingly hard to sustain as Austria's partners are striving to cut their taxes. There are good arguments in support of far-reaching tax reform, focusing in particular on reducing distortions and lowering the tax burden on labor and capital. Tax relief should not be pursued as a goal in its own right but as a means to maximize economic gains. Moreover, sacrificing fiscal prudence for lower taxes would be self-defeating, as it would undermine the credibility of the authorities' fiscal policy strategy and trigger the need for a fiscal correction later on. The key to successful tax reform is thus reform of public expenditures.

35. ***Adopting a medium-term fiscal framework would benefit the fiscal policy debate and implementation.*** It would help ensure the consistency of multiple policy objectives, illustrate policy tradeoffs, and increase transparency. This would in turn facilitate generating broad-based consensus on the key objectives and the necessary measures to reach them.

36. ***The need to start addressing the consequences of population ageing is urgent.*** Demographic trends represent the most serious threat to the long-term sustainability of Austria's public finances, but public awareness remains limited and preparations slow. Given the large precommitment element in pension spending, policies have to be proactive. Bold reforms to lengthen working life—which is short in Austria relative to most other advanced economies—and contain benefits are urgently needed if the rapid worsening of the pension system's finances from 2010 onwards is to be avoided.

37. ***Recent changes in financial supervision are welcome, but the challenge to turn them into more efficient and effective supervision still lies ahead.*** With the recent creation of the FMA and revisions to the Banking Act, Austria has a state-of-the-art legislative and regulatory framework for financial supervision. This must now be effectively used. The FMA needs to build up its supervisory capacity, develop a common culture for its staff, and capitalize on the synergies of a single agency while closely cooperating with the OeNB to prevent gaps in supervision and avoid duplication. In view of the growing cross-border linkages of the Austrian financial sector, it is also necessary to continue establishing memoranda of understanding and good working relationships with foreign supervisors, particularly in the CEECs, where foreign exposure is concentrated. An FSAP would provide useful input to benchmarking and evaluating progress to-date.

38. ***The momentum behind structural reforms should be reinforced.*** Further privatization and deregulation, combined with regulatory reform and efforts to increase the public sector's efficiency, remain important for strengthening competition and raising the growth potential, all the more so as similar reforms are high on the agenda in other EU countries.

39. Staff welcomes Austria's plans to raise its ***official development assistance*** from its current level of 0.21 percent of GNP to at least 0.33 percent by 2006, and encourages the authorities to increase it further toward the international benchmark of 0.7 percent.

40. The Article IV consultation with Austria should be kept on the standard 12-month cycle.

Table 1. Austria: Basic Data

Total area	83,850 square kilometers
Total population	8.13 million
GDP per capita (2001)	US$ 23,200

	1997	1998	1999	2000	2001	2002 1/	2003 1/
	(Percentage changes at 1995 prices)						
Demand and supply							
Private consumption	1.7	2.8	2.7	2.5	1.3	1.5	2.6
Public consumption 2/	-1.5	2.8	2.2	0.9	0.7	0.0	1.5
Gross fixed investment	2.0	3.4	1.5	5.1	-2.7	0.9	2.3
Construction	-1.0	1.3	-0.7	0.3	-1.7	0.0	1.0
Machinery and equipment	5.8	5.2	4.0	11.7	-4.4	2.0	4.0
Inventory accumulation 3/	0.3	0.1	0.2	-0.3	0.0	-0.2	0.0
Total domestic demand	1.5	2.7	2.8	2.5	0.2	0.7	2.3
Exports of goods and nonfactor services	12.4	7.9	8.7	12.2	4.5	4.0	5.8
Imports of goods and nonfactor services	12.0	5.9	8.8	11.1	2.9	3.3	5.5
Foreign balance 3/	0.0	0.8	0.0	0.5	0.8	0.4	0.3
GDP	1.6	3.5	2.8	3.0	1.0	1.0	2.5
	(Percent changes; period averages)						
Employment and unemployment							
Labor force 4/	0.3	0.8	0.5	0.0	0.7	0.2	0.6
Employment 4/	0.3	0.6	0.9	0.8	0.5	-0.5	1.4
Unemployment rate (in percent)							
Registered 5/	6.4	6.5	6.0	5.3	5.5	6.3	5.7
Standardized 5/	4.4	4.5	3.9	3.7	3.6	4.3	3.8
Prices and incomes							
GDP deflator	0.9	0.5	0.7	1.2	1.9	1.1	1.7
Consumer price index	1.2	0.8	0.5	2.0	2.3	1.8	1.6
Gross compensation per employed person	1.4	2.0	2.2	2.3	4.3	2.5	2.5
Unit labor costs (manufacturing)	-7.5	-6.3	-5.0	-7.1	3.5	0.0	0.0

1/ Staff estimates and projections.
2/ Public consumption growth in 1997 was influenced by the statistical reclassification of public hospitals.
3/ Change as percent of previous year's GDP.
4/ Dependent labor force (does not include self-employed).
5/ In percent of total labor force. The standardized rate is survey-based according to EU standards.

Table 1. Austria: Basic Data (concluded)

	1997	1998	1999	2000	2001	2002 1/	2003 1/
				(In percent of GDP)			
Public finances 2/							
General government							
Expenditure	54.1	54.4	54.2	52.8	52.5	52.2	51.8
Revenue	52.1	51.9	51.8	51.2	52.4	51.7	51.6
Financial balance	-2.0	-2.5	-2.4	-1.7	-0.1	-0.5	-0.2
Of which							
Federal government	-3.0	-3.2	-2.6	-1.8	-0.7	-1.2	-1.0
Other levels of government	1.0	0.7	0.2	0.2	0.6	0.7	0.8
Gross debt (end of period)							
Federal government	58.6	58.2	59.4	58.7	57.2	56.5	54.4
General government	64.8	63.9	64.9	63.2	61.7	60.2	58.1
				(In billions of euros)			
Balance of payments							
Trade balance	-3.8	-3.3	-3.4	-3.0	-1.3	-1.3	-1.2
Current account	-5.8	-4.7	-6.3	-5.0	-4.6	-4.5	-4.0
(In percent of GDP)	-3.2	-2.5	-3.2	-2.5	-2.2	-2.1	-1.8
				(In percent)			
Interest rates and credit							
Domestic credit to nonbanks (percent change, eop) 3/	3.9	5.2	5.3	6.8	3.5	4.0	...
Three-month interbank rate 4/	3.5	3.6	3.0	4.4	4.3	3.5	...
10-year government bond 4/	5.7	4.7	4.7	5.6	5.1	5.3	...
				(Levels, period averages)			
Exchange rates							
Schillings per US$	12.2	12.4	12.9	14.9	15.4	...	...
Euro per US $ 4/	...	...	0.94	1.08	1.12	1.06	...
Nominal effective exchange rate 5/	102.9	103.1	102.1	99.9	100.2	100.4	...
Real effective exchange rate							...
ULC based 5/	83.2	82.0	80.3	78.8	78.5	78.7	...
CPI based 6/	102.3	102.3	100.4	97.7	98.5	98.3	...

1/ Staff estimates and projections.

2/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition--used by the Austrian authorities--differs from this due to the inclusion of revenues from swaps.

3/ For 2002, data refer to growth rate from March 2001 to March 2002.

4/ For 2002, data refer to June 11, 2002.

5/ For 2002, data refer to May 2002.

6/ For 2002, data refer to March 2002.

Table 2. Austria: Fiscal Projections and Fiscal Impulse Calculations 1/

	2000	2001	2002	2003	2004	2005
			(In percent of GDP)			
Revenue	51.2	52.4	51.7	51.6	51.5	51.5
Expenditure	52.8	52.5	52.2	51.8	51.5	51.3
Overall fiscal balance 2/	**-1.7**	**-0.1**	**-0.5**	**-0.2**	**0.0**	**0.2**
Federal government	-1.8	-0.7	-1.2	-1.0	-0.7	-0.7
Other levels	0.2	0.6	0.7	0.8	0.7	0.9
minus one-off measures and net lending						
Net subsidized lending 3/	0.4	0.4	0.3	0.3	0.3	0.3
Net sale of real estate 4/	0.1	0.1	0.1	0.1	0.1	0.1
Sale of UMTS licences	0.4	0.0	0.0	0.0	0.0	0.0
plus						
Cyclical adjustment	-0.3	0.3	1.0	1.0	0.8	0.5
minus						
One-off revenues 5/	--	0.5	--	--	--	--
Structural balance	**-2.9**	**-0.7**	**0.0**	**0.3**	**0.3**	**0.3**
plus						
Net interest payments	2.8	2.6	2.5	2.4	2.2	2.2
Primary structural balance	**-0.1**	**1.8**	**2.5**	**2.7**	**2.5**	**2.5**
Fiscal impulse 6/	**-0.1**	**-2.0**	**-0.7**	**-0.1**	**0.1**	**0.1**
Public debt	63.2	61.7	60.2	58.1	56.1	53.8
Memorandum item:						
Output gap 7/	0.7	-0.7	-2.1	-2.0	-1.5	-1.0
Overall fiscal balance, EDP definition 8/	-1.7	0.1	-0.4	-0.1	0.1	0.3

Sources: Austrian Statistical Office, Austrian Stability Program; and IMF staff projections.

1/ For 2002, projections based on estimates of the Ministry of Finance. For 2003-05, projections are based on the Stability Program's general government balance objectives and on staff macroeconomic and revenue estimates.

2/ On ESA95 basis.

3/ Subsidized lending minus repayments. Adjustment made in accordance with GFS methodology.

4/ Transactions considered as negative expenditure by Eurostat.

5/ Adjustment for estimated windfall gains from accelerated corporate income payments.

6/ Negative of the change in the primary structural balance.

7/ In percent of potential GDP.

8/ The Maastricht Excessive Deficit Procedure (EDP) definition is used by the Austrian authorities. The difference from ESA95 is due to the inclusion of revenues from swaps.

Table 3. Austria: Medium-Term Macroeconomic Projections

	2000	2001	2002	2003	2004	2005	2006	2007
	(Percentage changes at 1995 prices)							
National accounts								
GDP	3.0	1.0	1.0	2.5	2.8	2.9	2.9	2.8
Domestic demand	2.5	0.2	0.7	2.3	2.5	2.8	2.8	2.6
Private consumption	2.5	1.3	1.5	2.6	2.7	2.9	2.9	2.9
Fixed investment	5.1	-2.7	0.9	2.3	3.5	3.1	3.2	3.2
Exports	12.2	4.5	4.0	5.8	5.9	5.7	5.5	5.4
Imports	11.1	2.9	3.3	5.5	5.4	5.6	5.4	5.2
	(Percentage change)							
Prices and unemployment								
CPI inflation	2.0	2.3	1.8	1.6	1.5	1.5	1.5	1.5
GDP deflator	1.2	1.9	1.1	1.7	1.4	1.4	1.4	1.6
Unemployment rate (in percent)	3.7	3.6	4.3	3.8	3.6	3.4	3.2	3.2
	(Percent of GDP)							
External accounts								
Current account balance	-2.5	-2.2	-2.1	-1.8	-1.5	-1.4	-1.2	-1.0
Goods and services balance	-0.6	-0.1	0.1	0.3	0.7	0.9	1.1	1.4
Net factor income	-1.2	-1.4	-1.4	-1.3	-1.4	-1.5	-1.6	-1.7
Transfer balance	-0.7	-0.7	-0.8	-0.8	-0.7	-0.7	-0.7	-0.7
Capital account	-0.2	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2
Financial account	2.0	1.8	2.4	2.0	1.7	1.6	1.4	1.2
Government accounts 1/								
Revenue	51.2	52.4	51.7	51.6	51.5	51.5	51.5	51.4
Expenditure	52.8	52.5	52.2	51.8	51.5	51.3	51.1	50.8
General government balance	-1.7	-0.1	-0.5	-0.2	0.0	0.2	0.4	0.6
Memorandum item:								
Potential growth (in percent)	2.5	2.4	2.4	2.4	2.4	2.4	2.3	2.3
Output gap 2/	0.7	-0.7	-2.1	-2.0	-1.5	-1.0	-0.5	0.0

Sources: Austrian official publications; International Monetary Fund, International Financial Statistics; and staff estimates.

1/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition differs from this due to the inclusion of revenues from swaps.
2/ In percent of potential GDP.

Table 4. Austria: Indicators of Financial Vulnerability

(In percent of GDP, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002 Latest	2002 Date
External indicators							
Exports (annual percentage change, in U.S. dollars)	-1.7	6.8	3.9	0.4	2.8	...	
Imports (annual percentage change, in U.S. dollars)	-1.1	4.3	4.4	-0.3	1.8	...	
Terms of trade (annual percentage change)	0.3	0.2	-0.6	2.2	1.3	...	
Current account balance	-3.2	-2.5	-3.2	-2.5	-2.2	...	
Capital and financial account balance	2.9	2.7	3.2	1.8	1.5	...	
Of which: Inward portfolio investment (net, debt securities)	4.3	8.0	11.5	13.9	10.8	...	
Inward portfolio investment (net, equity)	1.3	0.5	1.0	1.9	-2.3	...	
Inward foreign direct investment	1.3	2.1	1.4	4.5	2.8	...	
Other investment liabilities (net, inward=positive)	2.5	0.8	9.4	7.0	0.5	...	
Official Reserves (in billions of U.S. dollars)	19.7	22.4	15.1	14.3	12.5	12.6	April
Foreign assets of the financial sector (in billions of U.S. dollars)	118.9	123.1	140.2	145.8	140.0	...	
Foreign liabilities of the financial sector (in billions of U.S. dollars)	135.2	141.1	157.1	161.4	155.6	...	
Official reserves in months of imports	2.6	2.9	1.9	1.8	1.5	...	
Total external debt	16.4	18.7	18.7	17.1	...	...	
External debt to exports ratio (in percent)	39.2	42.8	40.9	33.6	...	...	
Exchange rate against U.S. dollar (period average)	...	...	...	1.08	1.12	1.06	12-Jun
Public sector							
General government balance 1/	-2.0	-2.5	-2.4	-1.7	-0.1	-0.4 2/	
Structural balance 3/	-2.4	-2.8	-2.9	-2.9	-0.7	0.0 2/	
Public sector debt 1/	64.8	63.9	64.9	63.2	61.7	60.2 2/	
Extrabudgetary debt 4/	12.0	13.0	13.2	12.7	...	...	
Federal government guarantees	28.7	28.4	28.8	27.9	28.0	...	
Financial sector							
Growth rate of credit to the private sector 5/ 6/	3.9	5.2	5.3	6.8	3.5	4.0	March
Stock market index (level) 7/	129.5	112.1	119.8	107.3	114.0	126.6	12-Jun
Price-earnings ratio 8/	16.3	18.5	16.6	18.8	15.3	18.2	31-May
Foreign exchange loans 6/	8.8	12.8	16.8	19.3	20.1	20.6	March
Foreign exchange loans, share of total loans 6/	8.3	12.2	15.7	17.5	18.2	19.1	March
Deposits in foreign exchange 6/	6.3	5.6	1.6	1.6	1.3	1.4	March
Deposits in foreign exchange, share in total deposits 6/ total deposits 6/	7.3	6.4	1.8	1.9	1.4	1.6	March
Risk-based capital asset ratio, total	12.9	14.3	13.9	13.8	14.6	14.4	March
Risk-based capital asset ratio, core capital	9.0	9.8	9.4	9.1	8.6	9.8	March

Sources: OeNB; Datastream; Bloomberg; Ministry of Finance; International Financial Statistics; and staff estimates.
1/ European System of Accounts, 1995 (ESA95).
2/ Staff projections.
3/ General government deficit according to ESA 95 adjusted for cyclical effects, one-off measures.
(e.g., asset sales), and net subsidized lending.
4/ Debt of government-owned enterprises.
5/ Excluding financial institutions and foreigners.
6/ Domestic nonbanks.
7/ For ATX index (1991=100) data refer to end of year.
8/ Price-earnings ratio for ATX.

Austria: Fund Relations
(As of May 31, 2002)

I. **Membership Status:**
(a) Date of membership: August 27, 1948.
(b) Status: Article VIII, as from August 1, 1962.

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	1,872.30	100.00
Fund holdings of currency	1,233.24	65.87
Reserve position in Fund	639.08	34.13
Financial transaction plan transfers (net)	43.00	

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	179.05	100.00
Holdings	141.08	78.79

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None

VIII. **Exchange System:**

As of January 1, 1999, the currency of Austria is the euro.

Austria's exchange system is free of restrictions on the making of payments and transfers for international transactions. However, Austria maintains exchange restrictions against Iraq pursuant to U.N. Security Council Resolution No. 661. These restrictions were notified to the Fund under Decision No. 144.

IX. **Last Article IV Consultation**

Discussions for the 2001 Article IV consultation were held in Vienna during March 23–April 3, 2001. The authorities agreed to conclude the consultation on a lapse-of-time basis.

IX. **Technical Assistance:** 7/19-8/4/2000 FAD Evaluate current systems of public pensions and intergovernmental fiscal relations

X. **Resident Representatives:** None

XI. **Other** None

Austria: Statistical Issues

Austrian statistics are adequate for surveillance. Austria has subscribed to the Fund's Special Data Dissemination Standard (SDDS), and Austrian metadata are available on the Fund's electronic Dissemination Standards Bulletin Board (http://dsbb.imf.org). Austria has taken advantage of the SDDS flexibility options on the timeliness of the industrial production index and merchandise trade data.

The timeliness of Austrian data could be improved by bringing them up to "best practice" in Europe with regard to national accounts data, industrial production, the (accrual based) current account, and merchandise trade. Compared to Germany and France, for instance, the publication of these data lags by about one month.

The transition to the new European Standard of Accounts (1995) has complicated the analysis of Austrian national accounts, as the new national accounts data provide no information on household disposable income (only an economy-wide aggregate), barring the calculation of a household saving ratio. In addition, the reclassification of public hospitals in 1997 has introduced a break in the national account series on public and private consumption. Fiscal data from 1995, compiled in accordance with *1995 ESA*, are not complete. From 1995, expenditure by function and financing and debt data have not yet been reported for inclusion in the *GFS Yearbook.*

A large difference between the data on goods trade recorded by the statistical office (Statistics Austria) and the payments data recorded by the National Bank has given rise to significant problems in assessing the developments in the foreign trade balance and the current account in the recent years (data on accrual basis are only available with a long time lag). Data based on the fifth edition of the Balance of Payments Manual are only available back to 1992.

Austria: Core Statistical Indicators 1/
As of June 20, 2002

	Industrial Production	Consumer Price Index	Exports/ Imports	Current Account Balance 2/	Overall Government Balance 3/	GDP/GNP	External Debt
Date of Latest Observation	3/02	5/02	3/02	3/02	2001	01Q4	2000
Date Received	5/29/02	6/19/02	6/14/02	5/22/02	2/28/02	3/19/02	3/1/02
Frequency of Data	Monthly	Monthly	Monthly	Monthly	Annual	Quarterly	Annual
Frequency of Reporting	Monthly	Monthly	Monthly	Monthly	Annual	Quarterly	Annual
Source of Update	Statistics Austria	Statistics Austria	Statistics Austria	OeNB	MoF	WIFO	OeNB
Mode of Reporting	Electronic	Electronic	Internet	Internet	Internet	Email	Internet
Confidentiality	None	None	None	None	None	None	None
Frequency of Publication	Monthly	Monthly	Monthly	Monthly	Annual	Annual	Annual

OeNB = Austrian National Bank
WIFO = Austrian Institute of Economic Research
MoF = Federal Ministry of Finance

1/ Austria is a member of the European Monetary Union. Exchange rates, foreign reserves, the central bank balance sheet, interest rates and other monetary indicators are published by the European Central Bank.
2/ Cash basis.
3/ National accounts basis.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 02/89
FOR IMMEDIATE RELEASE
August 14, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with Austria

On August 7, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.[1]

Background

After decelerating sharply in 2001, economic growth in Austria is projected to strengthen gradually during 2002, parallel to the expected improvement in the global economic climate. Real GDP growth is projected to average 1 percent this year, supported by a recovery in investor confidence and strong competitiveness. Despite the recent increase, the unemployment rate remains one of the lowest in Europe at about 4 percent. After rising to above 2 percent in 2001, headline inflation subsided to 1.6 percent in May.

After years of policy drift, fiscal policy had targeted balancing the general government budget by 2002. The government's 2001-02 adjustment program combined a tax package, savings on expenditures at the federal level, and savings by the subnational levels of government. In the event, general government balance was reached already in 2001, one year ahead of schedule, on account of cautious budgeting on the revenue side, larger-than-expected effects from the tax measures of the adjustment program, and strict expenditure discipline. The government intends to stick to its fiscal adjustment plan in 2002.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion or review by the Executive Board. At the conclusion of the discussion or review, a summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board discussion.

Austria's financial sector has benefited from globalization, in particular from the expansion in central and eastern Europe. The supervisory and prudential frameworks for the financial sector have adapted to the new challenges, notably with the creation of a unified and independent supervisory agency. The agency, which has responsibility for banks, insurance companies, capital markets and pension funds, began operations on April 1, 2002.

Reforms to liberalize the economy and privatize state holdings in commercial enterprises have been given a new momentum. The first phase of the authorities' privatization program has been concluded. The liberalization of the electricity and gas markets will be completed ahead of EU deadlines, an independent competition authority has been established, and legislation has been recently introduced which aims at streamlining regulatory and administrative requirements for businesses.

Executive Board Assessment

Executive Directors commended Austria's solid growth performance and low unemployment and inflation. Although growth weakened considerably in 2001, conditions are in place for a gradual strengthening of activity in the second half of 2002, due in large measure to the authorities' sound macroeconomic and structural policies. Directors recommended that the authorities continue to strengthen their focus on medium- and long-term objectives, in order to help sustain Austria's good economic performance and cope with the challenges of population aging and globalization.

Directors commended the progress already achieved by the authorities in imparting a greater medium-term orientation to policy. Setting general government balance as the medium-term fiscal objective, and implementing the adjustment measures necessary to achieve it, were important steps to ensure sound public finances. Establishing an independent financial supervisor—the Financial Market Authority—and revising prudential and other regulations have modernized the supervisory framework. The renewed commitment to implement structural reforms—demonstrated by completion of the first phase of the privatization program, advancing deregulation of the network industries, and establishment of a new competition authority—has laid the groundwork to enhance the economy's fundamentals.

In light of Austria's medium-term goal of general government budget balance over the cycle, Directors endorsed the planned continuing fiscal retrenchment this year, noting in this connection the outlook for the economy and the setting of supportive monetary conditions. The authorities' intention to implement permanent expenditure reduction measures to replace last year's one-off revenue measures was welcomed.

Directors stressed that it will be important to safeguard the credibility of the authorities' fiscal strategy. In that light, any relaxation of the fiscal stance in the coming years would be undesirable. Noting the role of fiscal policy in stabilizing the economy, some Directors stressed that fiscal surpluses would be in order in periods when economic activity is strong. Directors also emphasized that the lower levels of government would also need to contribute to adjustment—within the framework of Austria's "internal stability pact"—and that public sector wage restraint would be critical.

In light of Austria's high tax burden, Directors endorsed the authorities' strategic goal of reducing the tax ratio substantially over the medium term. However, they cautioned that this goal must not jeopardize fiscal prudence and urged the authorities to combine tax relief with reductions of public expenditure so as not to endanger general government balance. Directors noted that a more detailed and comprehensive medium-term fiscal policy framework—including medium-term expenditure targets—would help ensure the consistency of multiple policy objectives, illustrate policy tradeoffs, and increase transparency. They welcomed the authorities' intention to adopt this approach.

Directors urged the authorities to address the particularly severe consequences of population aging, which imply a serious threat to the sustainability of the public finances. Public awareness of this threat remains limited, however, and preparations for dealing with it have been slow. Pension reforms aimed at extending the period of working life and containing benefits are needed urgently to avoid a worsening of the public pension system finances over the longer run. Several Directors saw a case for more ambitious fiscal consolidation in this long-run context. Directors warned against any complacency concerning demographic trends and urged timely implementation of the necessary measures.

Directors commended the recent institutional and legislative changes that have helped strengthen the financial sector supervisory and prudential framework—in particular, the creation of the Financial Market Authority (FMA). The FMA should cooperate closely with the Austrian National Bank, in order to avoid gaps in supervision and duplication. In light of the growing cross-border linkages of the Austrian financial sector, the authorities should continue their vigilance, and work toward closer cooperative relationships with supervisors in other countries—particularly in Central and Eastern Europe, where foreign exposure is concentrated.

Directors noted with satisfaction that Austria is complying fully with all the recommendations of the Financial Action Task Force. The authorities' commitment to participate in a Financial Sector Assessment Program at an early juncture is also welcome.

Directors encouraged the authorities to reinforce the momentum of their structural reforms. They emphasized further privatization, deregulation and regulatory reform, and greater labor market flexibility in order to strengthen competition and raise growth potential, in the context of the further challenges of globalization and coming EU enlargement.

Directors welcomed Austria's plans to raise its official development assistance to at least 0.33 percent of GNP by 2006, and encouraged the authorities to increase it further toward the international benchmark of 0.7 percent of GNP.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with Austria is also available.

Austria: Selected Economic Indicators

	1998	1999	2000	2001	2002[1]
Real economy (change in percent)					
GDP	3.5	2.8	3.0	1.0	1.0
Domestic demand	2.7	2.8	2.5	0.2	0.7
CPI (year average)	0.8	0.5	2.0	2.3	1.8
Unemployment rate (in percent)	4.5	3.9	3.7	3.6	4.3
Gross national saving (percent of GDP)	23.6	22.1	20.8	21.6	20.7
Gross domestic investment (percent of GDP)	26.1	25.3	24.9	23.8	22.9
Public finance (percent of GDP)					
Central government balance	-3.2	-2.6	-1.8	-0.7	-1.2
General government balance	-2.5	-2.4	-1.7	-0.1	-0.5
General government debt	71.3	69.5	63.2	61.7	60.2
Money and credit					
(end of year, percent change)					
Domestic credit	5.1	4.9	7.5	3.8	…
M3	3.0	4.7	2.6	7.3	…
Interest rates (in percent)					
Money market rate [2] [3]	3.5	3.0	4.4	4.3	3.4
Government bond yield [3]	4.7	4.7	5.6	5.1	5.1
Balance of payments (percent of GDP) [4]					
Trade balance	-1.7	-1.7	-1.5	-0.6	-0.7
Current account	-2.5	-3.2	-2.5	-2.2	-2.2
Fund position (as of May 31, 2002)					
Holdings of currency (in percent of quota)					65.9
Holdings of SDRs (in percent of allocation)					78.8
Quota (in millions of SDRs)					1,872.3
Exchange rate					
Exchange rate regime	Member of euro area				
Euros per U.S. dollar (June 27, 2002)	…	…	1.08	1.12	1.01
Nominal effective rate (1990=100)	103.1	102.1	99.9	100.2	100.4
Real effective rate (1990=100) [5]	82	80.3	78.8	78.5	78.7

Sources: International Financial Statistics; Austrian National Bank; Austrian Statistical Office; and IMF staff projections.
[1] IMF staff projections.
[2] Refers to euro rate beginning in 1999.
[3] For 2002, data refer to June 27.
[4] On a transaction basis.
[5] Based on relative normalized unit labor costs in manufacturing.

Statement by Johann Prader, Alternate Executive Director for Austria
August 7, 2002

The Austrian authorities appreciate their consultations with the Fund and the high quality of the staff report, including the special studies on population aging and the economic effects of enlarging the European Union. They broadly agree with the staff's assessment of Austria's economic situation and its general recommendations on economic and financial policy.

The staff report and the Selected Issues studies are not only a presentation of Austria's problems but also a demonstration of its strengths and assets in terms of price stability, productivity growth, moderate wage policy, low unemployment, sound medium-term fiscal policy orientation, strong institutions, ability to reform and ability to identify and exploit the new opportunities for Austrian business and finance offered by European enlargement.

1. Fiscal Policy

When the present government entered office it undertook a major shift in economic policy, which included a much faster pace of fiscal adjustment, as advised by the IMF, and *inter alia* resulted in a balanced budget in 2001, a year earlier than planned. This was the first time in over 30 years that Austria's general government budget was not in deficit.

This policy change came at a difficult moment, since 2001 saw the Austrian economy, along with most others in Europe, slow sharply. This slowdown has continued longer than expected, most probably resulting in a general government deficit of 0.4 percent of GDP in 2002. But most recent forecasts by Austrian research institutes agree that a significant recovery of economic activity will occur in the second half of this year.

The policy shift was also accompanied by changes in the structure of revenues and expenditures, and a new approach aimed at realigning all levels of government with this new direction (the "internal stability pact").

The early restoration of budget balance resulted partly from a change in the timetable for paying assessed taxes, a step which produced surprisingly high additional revenues. The downside of this change was that taxes as a share of GDP reached a new high. In response the government has set itself the medium-term target of lowering the ratio of taxes to GDP to less than 40 percent by 2010. Lowering taxes as a share of GDP has been a longstanding recommendation of the Fund, the OECD, and the EU.

The possible launching of a tax reform now under discussion should be seen as one of Austria's medium-term policy goals. But the authorities are clearly determined not to let such a tax reform cause a departure from the successful consolidation path of the last two years. They remain fully committed to balancing the budget throughout the business cycle. In the present growth environment this means that any tax reductions must be balanced by significant savings on the expenditure side.

- over -

The authorities are cognizant of the staff's advice about the desirability of a medium-term fiscal framework. Achieving the 40 percent target just mentioned will require just such a framework to help policymakers through the necessary steps. The authorities are presently working on such a framework to assist in carrying out fundamental structural reforms on the expenditure side in line with the government's objective of streamlining the state's role in the economy. The staff points to several measures already taken to reduce distortions due to state interference, a goal to be pursued by privatizations, regulatory reforms, and downsizing the public sector.

2. Structural Reforms

The implementation of policies has continued, producing significant progress in several areas. Some of the most important ones are:

- In line with international trends, the financial market will be supervised by a new independent consolidated authority established on April 1 this year, which will be better able to respond to the challenges of global and domestic financial developments. This authority will cooperate closely with existing institutions, especially the Austrian National Bank. Early results show that this new consolidated agency has clear advantages over the former segmented arrangements. Unified, integrated supervision will become increasingly important with the growing complexity of financial services and the rapid emergence of financial conglomerates.

  The staff rightly notes that it is essential to establish close relations with foreign supervisors, especially in the Central and East European countries. A Memorandum of Understanding will soon be concluded with Slovakia. Negotiations have been started with Poland. And the authorities are in the process of reaching out to Bulgaria.

  The Austrian authorities are prepared to participate in an FSAP.

- Agencies concerned with implementing competition policies have been retooled with the best of European practices. The influence of social partners on competition policy has been curtailed in response to the perception that the system had been favoring the interests of market insiders at the expense of outsiders.

- Major reforms in the labor market have been achieved, including a reform of the severance pay system, which will supplement the pay-as-you-go system by providing the basis for a second pillar. This is a major achievement, and an additional step toward making the pension system sustainable. This being said, the Austrian authorities largely agree with the staff's analysis of the problem of population aging and its long-term consequences for the public finances.

- Key network industries have been liberalized, some of them well in advance of their EU-mandated deadlines.