

Austria: 2004 Article IV Consultation—Staff Report and Public Information Notice on the Executive Board Discussion

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 Article IV consultation with Austria, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **May 11, 2004** 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 1, 2004.** 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 2, 2004 discussion** of the staff report that concluded the Article IV consultation.

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.

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IMF Concludes 2004 Article IV Consultation with Austria

On August 2, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.¹

Background

The government in power since 2000 has set the objectives to balance the budget over the cycle, reduce the tax burden to 40 percent of GDP by 2010, contain fiscal pressures from population ageing, and increase Austria's growth potential. Concrete steps so far include the first (albeit small) fiscal surplus in more than 30 years in 2001; pension reform in 2003; privatization and deregulation in product and labor markets over the past four years; and tax reform in 2004-05.

Austria has weathered the global slowdown relatively well. Real GDP grew 1 percent per year during 2001-03, buoyed by strong exports during most of the period. This was broadly in line with the average growth of the EU, but more than Austria's major EU partners. Despite a rebound of fixed investment in the second half of 2003, growth of real GDP decelerated to 0.7 percent as private consumption growth came to a halt in the last quarter. However, other indicators point to a gradual recovery of activity. The current account remained broadly

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 by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the August 2, 2004 Executive Board discussion based on the staff report.

balanced and competitiveness strong in 2003, despite the appreciation of the euro. Unemployment rose almost 1 percentage point during 2001-03, but, at 4.4 percent in mid-2004, remains well below the EU average. Inflation averaged 1.8 percent during the same period, among the lowest in the euro zone, and its rise to 2.1 percent in May 2004 reflects the impact of higher energy prices.

Short-term economic prospects are positive, although risks remain. Growth of real GDP is expected to pick up to 1.6 percent in 2004 and average 2.4 percent in 2005, supported by robust investment and exports. There are uncertainties related to the behavior of private consumption and the global environment, but risks to the outlook are balanced. The inflation outlook is benign.

Austria's fiscal policy has been guided by the objective to maintain a balanced budget over the cycle while making room for tax cuts. At 1.4 percent of GDP (on ESA95 basis), the general government deficit was on target in 2003. It is expected to narrow to 1.2 percent of GDP in 2004, 0.4 percent of GDP above budget plans, but consistent with maintaining the broad structural balance achieved in 2003. Following some measures in 2004, the first significant step in tax reform is planned for 2005. However, tax reform will contribute to a temporary widening of the general government deficit in 2005-06 as the corresponding expenditure savings needed to maintain a balanced budget over the cycle will come on stream gradually. Given the short-term outlook, this would represent a procyclical relaxation of fiscal policy in these two years. The government envisages a return to budget balance by 2008, when the next wave of tax reform is planned.

The recent Financial Sector Assessment Program concluded that the Austrian financial system is generally sound, well supervised, and resilient to shocks. Compliance with international standards in banking, insurance, securities, and anti-money laundering is high. The banking sector is profitable and well-capitalized, and has seen major restructuring, consolidation, and a successful expansion in Central and Eastern European Countries (CEECs) in recent years. Moreover, the large banks have made major strides in adopting best practices in risk management. Looking ahead, there are areas of potential risk stemming primarily from the exposure of Austrian banks in the CEECs and to foreign currency loans to households, and scope for strengthening supervision and reviewing the current deposit insurance system over the medium term.

Progress on the structural front has been impressive since 2000. Structural reforms are expected to boost productivity and growth in the long run, and some encouraging signs are already emerging. However, there is still unfinished business, most notably the harmonization of the various public pension schemes—a key commitment of the government.

Executive Board Assessment

Executive Directors commended the authorities for their success in balancing the budget, reducing taxes, containing public spending, and launching a reform process that has shown impressive results in a relatively short period of time. This sound record of economic

management has helped Austria weather the global slowdown relatively well. Directors endorsed the authorities' medium-term macroeconomic policy objectives of sustaining a balanced budget over the cycle, further reducing the tax burden, and pursuing structural reforms to increase Austria's growth potential. In this connection, the main policy focus in the period ahead should be to deal with the fiscal implications of tax and other reforms while maintaining macroeconomic stability.

Directors considered the short-term economic prospects to be generally favorable. They anticipated that the gradual recovery under way will strengthen toward the end of this year and accelerate in 2005, although a number expressed doubts about the strength of private consumption.

Directors agreed that tax reform over the medium term would improve Austria's international competitiveness and boost its growth potential, and in this vein, they supported the authorities' tax reform plans for 2005. Consistent with the objective of lowering the tax burden to 40 percent of GDP by 2010, Directors suggested that the focus in the next round of tax reform should be on reducing the tax burden on labor, which is relatively high by international standards.

Directors stressed that the success of tax reforms will hinge on the implementation of durable expenditure cuts, in particular in the areas of the public administration, health, and transfers. On current plans, the deficit in 2005-06 is likely to widen as a result of the tax reform, but would narrow again as expenditure savings come on stream in future years. Directors observed that the targeted deficit increase in 2005-06 will represent a substantial deviation from the objective of a cyclically adjusted balance, and the fiscal position would not return to balance until about 2007. Moreover, if the announced expenditure savings do not materialize fully, even these targets may be exceeded, raising questions about the government's medium-term policy intentions. In that light, a number of Directors encouraged the authorities to strive to bring the fiscal deficit in 2005-06 as close as possible to the target in order to protect policy credibility and ensure that further tax reforms can be implemented in later years. Directors observed that all levels of government will need to contribute to the fiscal consolidation, and viewed the ongoing negotiations with regional governments on a revenue sharing agreement as an opportunity to impress on them the need for savings at the regional level.

Directors concurred with the authorities that a fundamental redefinition of the role of the state in a modern market economy such as Austria's will be required to achieve the lasting savings needed to further reduce the tax burden and return to a structural budget balance. Toward that end, the work by the *Austria Convention* on a new constitution will provide an opportunity for streamlining relations between all levels of government and improving the efficiency of public services. In the same vein, Directors welcomed the progress made in designing a comprehensive medium-term fiscal framework, which will improve the transparency, planning, and implementation of spending decisions, and they encouraged the authorities to take the necessary legislative steps to implement it.

Directors welcomed that the recent FSAP had found the Austrian financial system to be generally sound, well supervised, and resilient to shocks. Compliance with international standards in the areas of banking, insurance, and securities is high. Directors also welcomed the prompt action taken by the authorities to address areas identified by the FSAP, including recent steps to strengthen financial supervision further and deal with the risks stemming from foreign currency lending. Directors observed that the expansion of Austrian banks in central and eastern Europe will require continued monitoring and vigilance to diminish the exposure of the banking sector to possible new risks. Looking ahead, further restructuring and consolidation in the financial system are likely to continue, requiring the authorities to maintain their proactive approach to supervision of the sector. Directors commended Austria's record of leadership in applying standards to counter money laundering and the financing of terrorism, and welcomed the authorities' commitment to continually review and enhance this regime consistent with international best practices.

Directors praised the authorities for their notable achievements on the structural front, and encouraged them to follow through with their reform agenda, as further deregulation of the economy will boost productivity and growth in the long run. Top priority should be given to the harmonization of the public and private sector pension schemes to bolster the credibility of the government and improve the fairness of the pension system. Directors urged the authorities to intensify their efforts to rationalize the disability pension, reform the health sector to raise efficiency and generate budgetary savings, liberalize services further, and complete the privatization program. Directors noted the favorable performance of the labor market even during the slowdown, but called for further steps to raise the participation of older workers in the labor force.

Directors welcomed Austria's commitment to trade liberalization and the objectives of the Doha Development Agenda. They commended Austria's contribution to official development assistance, and looked forward to further increases toward the UN target 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.

Austria: Selected Economic Indicators

	2000	2001	2002	2003	2004 1/
Real economy	Change in percent, unless otherwise noted				
GDP	3.4	0.8	1.4	0.7	1.6
Domestic demand	2.6	-0.2	0.0	1.8	1.7
CPI (year average) 2/	2.0	2.3	1.7	1.3	2.1
Unemployment rate (in percent) 2/	3.7	3.6	4.3	4.4	4.4
Gross national saving (percent of GDP)	22.9	22.6	23.8	23.2	22.7
Gross domestic investment (percent of GDP)	25.5	24.5	23.5	24.1	23.7
Public finance	In percent of GDP				
Central government balance 3/	-1.8	-0.7	-1.1	-1.9	-1.7
General government balance 3/	-1.7	0.1	-0.4	-1.4	-1.2
General government balance (EDP basis)	-1.5	0.3	-0.2	-1.3	-1.0
General government debt	67.0	67.1	66.6	64.9	64.2
Money and credit	End of year, percent change				
M3 4/	2.2	11.4	1.3	7.8	5.1
Domestic credit 4/	6.8	3.5	1.2	1.8	3.1
Interest rates	In percent				
Money market rate 5/	4.4	4.3	3.3	2.3	2.1
Government bond yield 5/	5.6	5.1	5.0	4.1	4.5
Balance of payments	In percent of GDP				
Trade balance	-1.4	-0.7	1.7	0.8	0.5
Current account	-2.6	-1.9	0.3	-0.9	-1.0
Fund position (as of April 30, 2004)					
Holdings of currency (in percent of quota)					59.8
Holdings of SDRs (in percent of allocation)					66.4
Quota (in millions of SDRs)					1,872.3
Exchange rates					
Exchange rate regime	Member of euro area				
Euro per US dollar 5/	1.09	1.12	1.06	0.89	0.83
Nominal effective rate (1990=100) 2/	99.9	100.2	100.6	102.6	103.0
Real effective rate (1990=100) 2/ 6/	78.7	78.5	79.0	80.7	81.2

Sources: IMF, International Financial Statistics; Austrian National Bank; Austrian Statistical Office; Federal Ministry of Finance; and IMF staff projections.

1/ IMF staff projections, unless otherwise indicated.

2/ The figure for 2004 refers to May.

3/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition—used by the Austrian authorities and in EU multilateral surveillance—differs from this due to the inclusion of revenues from swaps.

4/ The figure for 2004 refers to April.

5/ The figure for 2004 refers to June 16.

6/ Based on relative normalized unit labor costs in manufacturing.