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OECD Recommendations for Austria to Increase Growth and Employment

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Organisation for Economic Co-operation and Development

1. How Does the OECD Make Its Recommendations?

The Organisation for Economic Co-operation and Development (OECD) defines itself as a service organisation for its member governments. Its goal is to help governments to find ways how to improve policies in a wide range of areas. The overarching objective is to allow member countries to achieve a high level of economic development, which is sustainable in the long term.

The Secretariat – organised in Directorates and Departments – produces drafts, which are then discussed in the responsible Committees. Member countries send their experts to share own experiences and to provide country specific expertise. The peer review format of advice is applied to avoid asymmetric treatment and allows for a relatively low-cost transfer of best-practice policies. Recommendations, however, are always country specific and take the local socio-political constraints in member countries into account.

The Economics Department is in close contact with other Directorates and drafts are exchanged for consultation before being discussed in Committees in order to fully exploit specialised knowledge in all policy areas, which are relevant for economic growth. Within the Department the Country Studies Branch is responsible for the Economic Surveys (presented to, discussed and published by the Economic and Development Review Committee, EDRC) and the bi-annual revision of projections (published in the Economic Outlook under the responsibility of the Secretary General) while the Policy Studies Branch carries out cross-country policy assessment, which is discussed in the Economic Policy Committee (EPC) and its Working Party 1 (WP1). More recently the Department closed a gap with

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launching “Going for Growth” a cross country structural review process, which aims at helping member countries to more rapidly close the gap to the best performing economies.

2. Which Reforms Does Austria Need?

Austria’s economic performance is very good. Measured against a number of aggregate indicators it is typically not only among the best performing EU Member States, but also a top performer among OECD member countries. Many benchmarking and ranking exercises see Austria also among the leading economies. GDP per capita is high, potential growth is also above average while inflation and unemployment are low. (see table 1)

Table: Performance Indicators for Austria

Indicator	Austria	Euro area	OECD
GDP per capita in PPPs	31,700	27,700 (EU 15)	28,700
Potential growth	2.5	2.0 (Belgium)	3.3
2000–2005 in %		2.8 (Finland)	(New Zealand)
Unemployment in %	5.9	8.6	6.5
Inflation in % (2005)	1.9	1.9	2.0

Source: OECD; OECD Economic Outlook 79 database.

Hence, there is no need for radical reforms. Nevertheless, Austria’s performance could be even better if it would establish a climate of permanent readiness for reform. OECD recommendations aim at contributing to such a climate, which would also help to achieve the objectives of the Lisbon process.

3. OECD Recommendations for Economic Reform in Austria

OECD recommendations for economic reforms in Austria can be found in three regularly published documents:

- Economic Outlook – Country Note (bi-annual)
- Economic Surveys (2001, 2003, 2005)
- Economic Policy Reviews: Going for Growth – Country Note (2004, 2005)

The following sections summarise the main focus of OECD Recommendations since 2000. Overall Austria has one of the smallest income gaps relative to the benchmark U.S.A. The number of hours worked per working age adult is equally high as in the U.S.A. Only labour productivity exhibits some weakness.

3.1 Recommendations in the Economic Outlook

A recurrent theme in the Austria Notes of the Economic Outlook is some dissatisfaction with the performance of fiscal policy. Debt to GDP levels are too high and even rising, which is not warranted in the face of the equally severe ageing of the Austrian population and associated increases in public expenditures for old age income replacement and health care.

The zero-deficit – originally intended to be maintained every year – was only achieved in one year (2001) and since then general government debt relative to GDP stays stubbornly above 60%. Current government plans foresee achieving a balanced general government for the time after 2008, which is not very ambitious. While complying with the minimal constraints of the Maastricht treaty is not a problem for Austria some reduction in transparency came along with outsourcing some government agencies, which were responsible for transport infrastructure.

In some cases pro-cyclicality of government activities – both in terms of tax cuts and expenditure programmes – was observed and recommendations frequently requested to abstain from an activist fiscal policy. At the same time a tendency to consolidate the budget via one-off measures became a habit.

3.2 Recommendations in Economic Surveys

Recent Economic Surveys (2001, 2003, 2005) focused on a number of issues ranging from fiscal consolidation, public expenditure reform, fiscal federal relations, pension reform, labour market improvements, increasing the scope for competition, especially in domestic services industries and improving the environment for innovative activities. Sustainable development was addressed in a special chapter and followed up in subsequent surveys.

- *Structural reform and strict spending control are needed to make the fiscal turn-around sustainable*

Earlier episodes of fiscal consolidation in Austria before 2000 were succeeded by rapidly rising structural deficits. This reflects both the fact that past consolidation policies relied to a large extent on one-off measures and also that, with fiscal balances improving, new social entitlement programmes were instituted. Since 2000, balancing the budget appears feasible even though growth has slowed. However, several risks, both on the revenue and on the spending side, require tight spending control for the medium-term consolidation targets to be met. Most importantly, one-off measures continue to play a significant role in the government's savings programme, and not all parts of envisaged structural reform have yet been decided or implemented. Moreover, new spending programmes are envisaged, with the new family benefits that came into effect in January 2002 placing a heavy burden on the general government budget, accounting for some 1/3 percent of GDP. Hence, a sustainable elimination of the general government deficit

requires rapid replacement of the one-off measures by structural policies that are associated with lasting savings. The government has focused on administration reform as a source for budgetary savings. Major changes in government agencies have been carried out and Austria is also pressing ahead with the introduction of e-government. Over the years tax reductions have been implemented, but these have still to be backed up by structural reductions in government spending. Otherwise, there is a risk of a renewed spending cycle that would endanger the achievements made. Moreover, creating a budgetary surplus would help cope with fiscal pressures associated with ageing.

- *Introducing a medium-term fiscal framework, which would put Austria's fiscal balances on a sustainable path, allow automatic stabilisers to play its role in the business cycle and facilitate prioritisation and efficiency (i.e. cost-effectiveness)*

Significant expenditure cutting measures – which are not yet fully specified – will be needed to reach the government target of a balanced budget by 2008. The introduction of a medium term budgeting framework would help to strengthen the necessary prioritisation and output orientation of the budgeting process so as to avoid the economic costs of ad-hoc measures. Fiscal sustainability calculations should be regularly carried out for all levels of government. Further tax reforms should focus on base broadening in exchange for statutory rate cuts.

- *Reforming fiscal-federal relations, which were identified as overly opaque and costly.*

Sub-central levels of government rely largely on shared taxes, for which the federal government has full legislative responsibilities, and on federal government transfers. A large proportion of municipalities' and states' tax and transfer revenues are earmarked to specific spending programmes, often in terms of extra-budgetary funds, and there is widespread co-financing of spending items between the states and the municipalities. A complicated system of revenue redistribution reduces transparency. Reforms should focus on improving the revenue structure of lower levels of government. Dispersed decision making, notably in the health care system, but also as regards supra-regional infrastructure planning, should be harmonised and the scope for cooperation in service provision strengthened.

- *Increasing the scope for competition in a number of areas, especially among professional services, but also retail and handicrafts.*

The OECD growth study has provided evidence that competition-enhancing policies can foster the growth of productivity and employment. While some reforms of competition-related policies have been implemented in recent years, legal restrictions continue to impair competition in many product markets. Moreover, unduly restrictive regulations are particularly widespread in the services sector. This is manifest in comparatively weak productivity growth in this sector over the past decade, while manufacturing performed well by international comparison. In-depth analysis suggests that comprehensive reforms of the

domestically oriented industries and of public procurement policies could substantially boost consumer welfare.

Professional self-organisation tends to establish entry barriers, which contribute to a significant difference in productivity growth between sectors exposed to international competition and those, which are predominantly producing for local markets. A recent banking scandal highlights the weaknesses of Austria's rather informal personalised system of checks and balances relative to the OECD wide more usual rule based systems of supervision and prosecution of abuse of market dominance. In network industries "national champions" still enjoy political support. Zoning laws and shop opening hours regulations distort consumer and producer choices in retail trade. Weak performance is widespread in the services sector, owing in large part to regulations that thwart competition.

Productivity in retail distribution in general is lower than in many comparable countries. This reflects the fact that regulations of large stores and opening hours are stricter than elsewhere. For example, up to now average shop opening hours were the shortest in the European Union. Besides limiting consumer choice, these regulations prevent taking advantage of economies of scale. The federal government has widened the legal scope for extended shop opening hours. The *Länder* should make full use of this option; and broader liberalisation of the retail sector should be considered.

Trades and professions are subject to a complex set of regulations, comprising both statutory provisions and significant elements of self-regulation. There is evidence that this contributes to higher prices and the observed low firm turnover rates might also be related to restrictive regulations. There is considerable scope for discontinuing some existing provisions or reforming them so as to minimize their distorting effects on competition. For example, for those activities where certification is warranted in order to safeguard certain levels of quality, it should pertain to employees rather than owners. In professional services, recommended fee schedules, issued by the relevant associations, effectively prevent price competition and should be prohibited.

Recent reform of competition law took important steps towards aligning the Austrian framework with the mainstream. In particular, the reduction of the social partners' direct influence and the creation of an independent competition authority were commendable, albeit overdue. Yet the institutional set-up now in place and procedures for enforcement are overly complex. These shortcomings should be remedied. Most importantly, the currently inadequate capacity of the competition authority should be considerably increased. A leniency programme should be introduced and the introduction of criminal sanctions for hard-core cartels considered.

While Austria has been early to liberalise electricity demand, it is imperative that the structure of the industry becomes more competitive. At present, production and distribution remain characterised by extensive vertical integration and

government ownership. The latter follows directly from legal regulations of ownership and restrictions of voting rights. The government is actively encouraging further consolidation, while the competition authorities did not publicly advocate competitive solutions in the recent prominent merger case. Further domestic consolidation is considered necessary by the authorities for safeguarding the international competitiveness of Austrian producers after the imminent opening of the European electricity market. This is a misguided aim if it leads to higher prices for consumers, and it would impair the competitiveness of Austrian producers in other industries. Moreover, the consolidation might permanently prevent Austrian consumers from gaining the benefits of the larger European market.

- *Improving the incentives for innovative activities, also by improving general education components in vocational training. Subsidisation of enterprises is still widespread and introduces important entry barriers.*

A well educated labour force is key for an innovation-minded economy. Austria is spending a lot for its education system, but the outcomes are falling short of performance in many other countries. International experience suggests that a combination of national standards with a higher degree of school accountability for outcomes and a larger degree of freedom as concerns educational instruments and employment of teachers would help. Competition should be strengthened. As concerns start-ups of enterprises, the focus should be shifted from granting tax concessions to the improvement of general framework conditions, such as lowering barriers to entry and administrative burdens on entrepreneurial activity.

- *Increasing the labour supply for non-core age workers. Increasing the – exceptionally low – labour force participation rate for older workers, improving the compatibility of professional and family obligations, especially for women with small children, and reducing seasonal inactivity, which benefits from a large fiscal subsidy.*

Labour force participation needs to be increased by more effectively curbing early retirement and terminating the fiscal subsidisation of seasonal inactivity. Employers should fully finance the costs of early retirement on account of onerous work while invalidity pension schemes are in urgent need of reform.

- *Improving the cost effectiveness of environmental policies. As regards environmentally sustainable growth, Austria is acting from a position of relatively good environmental performance and with the ambition to further improve environmental outcomes. However, the policy mix being used relies too much on command and-control type measures, while a well-established framework for integrating environmental concerns into general policy planning is lacking. In particular, there is little ex ante and ex post evaluation of potential environmental benefits which would lead to changes in programmes or termination of ineffective programmes. Not least, this implies that policies directed at similar objectives are not well balanced so as to*

secure high degrees of overall efficiency. A consistent framework for cost-benefit analysis across policies should therefore be introduced. An ambitious Kyoto target serves as the flagship of Austria's climate change policy, which is a prime example for Austria's ambitious environmental goals. However, the policy mix applied for this purpose can be improved.

3.3 Recommendations in Going for Growth

Going for Growth is indicator based and identifies policy priorities in areas for which the country underperforms. Policy priorities are formulated according to cross-country studies, which establish a relationship between indicators, policies and performance. Such studies are typically discussed in EPC or its WP1. Close cooperation with other Directorates incorporates the rich wealth of competence throughout the OECD.

3.3.1 Policy Priorities in General

Reduce the Implicit Tax on Continued Work at Older Ages

Austria has already reduced financial disincentives to work at older ages, in addition to aligning pension arrangements for public sector workers on those in the private sector. However, public sector pensions are not yet harmonized across all levels of government, existing early retirement pensions are not actuarially fair for all workers, higher unemployment benefit entitlements are granted for older unemployed workers, and subsidies for old-age part-time employment are making early withdrawal from the labour market attractive. Such measures should be reconsidered and phased out.

Improve Graduation Rates from Tertiary Education

The share of labour force with tertiary graduation is among the lowest in the OECD. The government has introduced a major university reform including performance targets. Part of university funding is being linked to quantitative performance indicators. To raise participation in tertiary education, it was recommended that performance-based funding of tertiary institutions is strengthened, that academic requirements in occupational-oriented programmes – which establish inappropriate access barriers – is reduced and that a loan scheme for study fees with income-contingent repayments is introduced.

Strengthen Competition Law and Enforcement

Despite major reforms and increased staffing and resources for the Competition Authority much remains to be done to remove existing barriers and obstacles for

competition in Austria. To promote greater competition in product markets, it was recommended that more powers and resources be assigned to the Federal Competition Authority (FCA), that the institutional setup of competition policy be streamlined, that rules on vertical agreements be simplified and that the labour and commerce chambers' right to nominate lay judges be discontinued. Existing compulsory membership in professional chambers and their far-reaching powers in many areas important for competition should be reconsidered.

Reduce Administrative Burden on Start-Ups

Enterprise dynamics in Austria is low, although enterprises – once established – live longer. However, facing rapid technological change and pressures from globalisation makes it necessary to reduce the existing barriers to establish new firms and enter markets in Austria. The costs of setting up limited liability companies are high. Regulation of entry in trades and liberal professions is still cumbersome although requirements on professional qualification and experience for self-employed engineers and architects have been eased and bankruptcy procedures and restrictions on cross-holding of equity for businesses supplying related services have been relaxed. Membership in compulsory professional chambers is expensive. Progress along these lines would improve the environment for start-up, which would also re-enforce other reforms (like make universities more interested in commercialising their findings).

Reduce Inactivity Traps in the Benefit System

Recently introduced family benefits may impose a disincentive to stay economically active for women with small children. It is therefore recommended to restructure childcare benefits in favour of vouchers for child care, and that job-placement activities be better integrated with social assistance.

Policy Priorities for Improving the Environment for Innovative Activities

The 2005 “Going for Growth” exercise took a special look on innovation, an area which was also identified in many Economic Surveys for Austria as an area of concern. Austria showed average levels of R&D activity, scientific output and innovation output, below average levels of human resources and weak science-industry linkages and venture capital. More recently the Austrian economy has lost some momentum and is now growing more slowly than a number of other smaller OECD countries. It needs to enhance its ability to exploit advances in science and science-based technologies. R&D/GDP catching up but has still a significant innovation gap. Austria, for example, has been lagging behind in terms of total R&D investment as a share of GDP, largely due to low levels of industry-financed R&D. Nevertheless, it has achieved relatively high levels of GDP per capita (approximately USD 28,900 PPP in 2002) and has successfully leveraged strengths in niche markets, including through non-R&D based innovation efforts.

Improve Educational Achievements

The Austrian school system is segmented and favours early streaming of children. Between school variance is considerable. Mobility between different types of schools is reduced. Expenditures per student are high. In order to improve educational achievements and the efficiency of the school system country-wide performance targets for secondary schools should be introduced. At the same time their operational independence should be raised. In other words, schools should be free concerning the educational methods and means which allow them to help their students to achieve common targets. Further measures to widen access to tertiary education – accompanied by a loan programme with income-contingent repayments to help students fund study fees – should be considered.

Improve Access to Venture Capital

The venture capital market is small in Austria. Remove restrictive investment rules for venture capital funds. Ease quantitative restrictions on investment of pension funds in venture capital

Streamline Public Support for Business R&D

Simplify fiscal incentives for R&D spending, evaluate more via an independent agency.

Foster Product Market Competition and Entrepreneurship

Further reduce the cost of setting up public limited enterprises. Make regulation more conducive to competition in service industries, such as in professional services and retailing. Strengthen competition law enforcement.

Improving the environment for innovative activities and improving the efficiency of Austria's knowledge sector requires an integrated approach to a wide range of policies including competition policy, public support for R&D and innovation and intellectual property rights. Innovation policy needs to be much more "centre stage" within overall economic policy, interactions between Higher Education Institutions (HEIs)/Public Sector Research Establishments (PSREs) and business need to be enhanced, and R&D expenditure as well as other investment in knowledge further increased.

4. To Sum up

For Austria to even improve on its excellent economic performance OECD recommendations focus on four broad policy areas:

- firmly establishing sustainable fiscal policies and introducing a medium term expenditure framework. Increasing the efficiency of government operations

and continuing with administration reforms which reduced costs for the tax payer; reform fiscal-federal relations

- improve the scope for competition, especially in services sectors and liberal professions
- remove remaining obstacles to economic activity, in particular seasonal unemployment, early withdrawal from the labour market and families with small children
- strengthen the education system so as to respond effectively to the skill requirements of a rapidly changing knowledge based economy

Following these recommendations, monitoring results of policies and adapting measures where necessary will improve Austria's chances to make a significant contribution toward achieving the Lisbon targets of the European Union.

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