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Restarting sustainable growth: The role of fiscal policy

1 The economic upswing is delayed

When I took over as Minister of Finance in autumn 2014, Europe was in its 5th year of the recession. The aggregate hides, however, important differences between Member States. One can see, that the EU Member States that did their homework in terms of budget consolidation and structural reforms are now in the lead in terms of growth (e.g. Germany, Ireland, Spain). Also Austria did well in the beginning of the crisis. Thanks to the solid fiscal policy before the crisis, Austria had enough leeway to kick-start the economy in the crisis. So the economy was in the recession for one year only and growth picked up in 2010/2011. This is to say, the recession was v-shaped, whilst the European Commission and many others had forecast an L-shaped path of growth. Then we embarked on fiscal retrenchment (0.75% of GDP annually in structural terms over four years in the period 2011–2014. Whilst the nominal deficit dropped below the 3% mark already in 2011; in 2014, we already managed to reach the Austrian medium-term budget objective which was set at 0.45% of GDP.

Notably, in the period 2012–2014 real GDP growth was pretty low in the period 2012–2014 and forecasters see also subdued growth in 2015. Growth is now forecast to speed-up to a range between 1.4% and 1.7% in 2016.

2 Action is required: The need to reform public finances

The crisis has left us the legacy of high public debt which stands at 86.8% in 2015. This was partly caused by the costs of the banking sector to the tax payer. The other important effect is a high tax burden due to a ratio of public

expenditures to GDP of 52.3% in 2014, which is among the highest of the OECD countries. Already before the crisis it was clear that the ageing of the population will put additional pressures on public finances. In addition, international institutions have been telling Austria for many years that our federal fiscal relations are complicated, not transparent and inefficient. Last, but not least, there are the banking issues.



3 The way forward has to tackle the problems

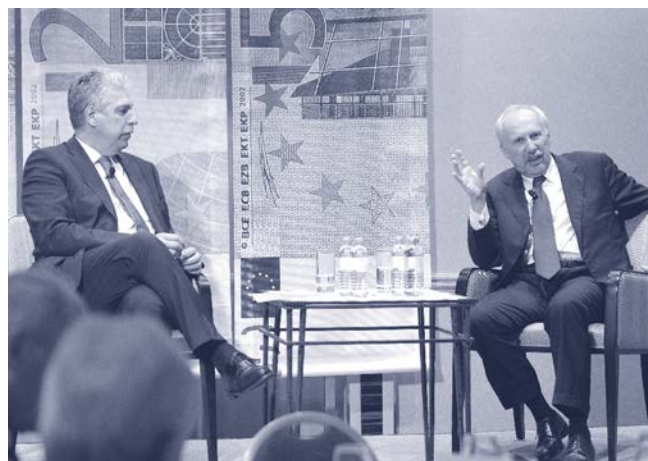
3.1 The tax reform

A tax reform was long due! The purchasing power of the people was eroded by high effective tax rates and work incentives were low for the lower incomes. Austria has also lost ground in the ranking of the “Doing Business Report” by the World Bank. In the past, tax reforms were mostly deficit financed. With a record-high debt burden this was no option. We have found a compromise: My first priority was to reduce public expenditures. From the more than EUR 5 billion volume of the tax reform, we agreed on reducing public spending by EUR 1.1 billion as a first step.

Austria is competing with other business locations and labour costs are

comparably high. We have agreed on reducing indirect labour costs as a next step. But we have to create the room for that on the expenditure side first – on all layers of the government. Thus, it will be key that we will agree on a better division of tasks and financing in the upcoming negotiations on the “Finanzausgleich” (Financial Equalisation Scheme).

We also must continue to produce “value-for-money”: No red tape, low administrative burden on business, a lean organisation (by region and by function), no duplication of competences, no over-staffing and no under-resourcing. This is, for instance, why the government has set up a working group on administrative reform, the so called Task and Deregulation Commission. In 4 subgroups, it is mandated to come up with recommendations on the



reduction of bureaucracy and on task reform including the institutional relationship between the federal, the state and the municipal level and on economic affairs and on subsidies. At the end of this process – this is my aim – I want to achieve substantial savings on public expenditure. As we could not implement further measures on the expenditure side so quickly, we had to develop other means of financing of the tax reform.

Most controversial is the checking of banking accounts of enterprises and entrepreneurs (which is already possible today). Let me assure you that all these measures are and will continue to be protected by tax secrecy.

The economic research institutes have analysed the tax reform. They confirm the positive effects on growth and employment for Austria. They also confirm that this tax reform will not burden future generations.

3.2 Investing into the future

Let me now turn to my favourite theme. If Austria wants to withstand the pressure of international competition, it must be able to adjust and to innovate. If you look at public finances, a big part of the budget is blocked by un-financed promises of the past: public pensions amount to 14% of GDP, interest payments for public debt amount to 2.4% of GDP (currently helped by low interest rates). Also health care is costly and expenditures are dynamic due to ageing and technological pressures. To show an example of the ageing issue: In the period 2013–18 pensions in the federal budget (social insurance and federal civil service scheme) will increase by further EUR 4.2 billion. By comparison: looking at expenditures dedicated to the future, public spending on education, families and R&D will rise by relatively moderate EUR 1.3 billion. Due to ageing societies, the trend is expected to even worsen, if no reforms are implemented! This is why I will inaugurate a reform group on pensions to deliver several options for reforms.

On innovation, we must also focus more on e-Government and the working methods of the public administration must be able to meet the requirements of changing demands. I am also happy that we achieved to increase the tax premium for R&D from 10% to

12% in the framework of the tax reform.

3.3 Financing of the economy

The crisis has highlighted the need to have a stable financing of the economy. Despite the problems of Kommunal-kredit, HypoAlpeAdria (HETA) and Österreichische Volksbanken-AG (ÖVAG), one can say that unlike other EU Member States, Austria did not experience a credit crunch. This was, of course, helped in the beginning by the government's EUR 100 billion envelope in support of the banks (most of it was dedicated to liquidity support). The crisis has spurred European integration in this field, which I regard as positive for two reasons: First, we have now a level-playing field for the banks due to central supervision and common rules for the recovering and restructuring of banks. Secondly, there is the chance for a truly European financial market with enhancing the ef-

iciency of financing of our economies. The latter is still in the making. The project "Capital Markets Union" is aiming at SME financing. SMEs are the backbone of the Austrian economy.

The crisis has also highlighted one important element, at which my political party for many years hinted. There is a need for high equity capital. Thus, the government has worked on innovative financing, such as crowd funding or new methods of mezzanine financing. Within the tax reform, we have also increased the preferential treatment of buying equity by the employees. Noteworthy, this is also why my party has rejected ideas of taxing embodied capital of companies.

Looking forward to the remaining legislative period, a lot is in the making, but a lot has to be done. Despite the troubles and the heavy workload, I am still very happy to contribute to this work as Minister of Finance.