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COVER NOTE

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Delegations will find attached document SWD(2014) 168 final.

This document is aimed for discussion in the **Eurogroup.**

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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Updated Draft Budgetary Plan of AUSTRIA

Accompanying the document

COMMISSION OPINION

on the Updated Draft Budgetary Plan of AUSTRIA

{C(2014) 3389 final}

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1. INTRODUCTION

Due to general elections, which took place on 29 September 2013, the outgoing federal Austrian government on 15 October 2013 submitted a Draft Budgetary Plan (DBP) on the basis of unchanged policies, constituting a mere technical update of the 2013 Stability Programme. In January 2014, the government adopted a provisional budget, covering the period up to the adoption of a fully-fledged budget for 2014-15.

According to the Commission opinion of 15 November 2013 on the DBP, there were risks that Austria would not fulfil the requirements of the preventive arm of the Stability and Growth Pact (SGP). In particular, the Commission forecast pointed to non-compliance with respect to the adjustment path towards the MTO in 2014. On this basis, the Commission invited the national authorities to ensure full compliance with the SGP by submitting to the Commission and to the Eurogroup an updated DBP taking into account its Opinion as soon as a new government took office.

On 29 April 2014, Austria submitted to the Commission an updated DBP for 2014 and a DBP for 2015. On the same day the updated DBP was presented to the Austrian Parliament. The DBP is included in the Stability Programme which was submitted in compliance with the requirements of the Stability and Growth Pact. This Staff Working Document (SWD) provides an assessment of the compliance of the updated DBP with the obligations of the Stability and Growth Pact. The SWD mainly focuses on the year 2014.

Austria is subject to the Excessive Deficit Procedure since 2009. The general government deficit was below 3% of GDP both in 2011 and in 2012. The outcome for 2013 is a deficit of 1.5% of GDP. The Commission Spring 2014 forecast indicates that a sustainable correction of the deficit has been achieved, given that it is projected to remain below 3% of GDP also over the forecast horizon. Austria will be subject to the preventive arm of the Pact as from 2014, under the assumption that the Council decides to abrogate the excessive deficit procedure (EDP) for Austria based on a Commission proposal. According to the requirements of the preventive arm, Austria needs to ensure compliance with the adjustment path towards its medium-term budgetary objective (MTO), set at a structural deficit of 0.45% of GDP. Austria is required to pursue an annual structural adjustment of above 0.5% of GDP in 2014, which has been operationalized in consultation with Member States as a requirement of an effort of at least 0.6% of GDP.

Section 2 of this document presents the macroeconomic outlook underlying the updated DBP and provides an assessment based on the Commission's most recent forecast[1]. Section 3 presents the recent and planned fiscal developments according to the updated DBP, including the additional measures for 2014 announced by the Austrian Government on 12 May... Section 4 assesses the recent and planned fiscal developments in 2014- (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE UPDATED DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the updated DBP for 2014 and 2015 is based on the

[1] As published on 5 May 2014.

macroeconomic forecast of the independent Austrian Institute of Economic Research (WIFO) as of 27 March 2014. The macroeconomic scenario of the updated DBP and the Spring 2014 Commission's forecast share broadly similar projections for nominal and real GDP over 2014 and 2015 as well as a number of other similarities, but also non-negligible differences, notably on the growth composition.

Table 1. Comparison of macroeconomic developments and forecast

	2013	**2014**		**2015**	
		DBP	**COM**	**DBP**	**COM**
Real GDP (% change)	0.4	1.7	1.6	1.7	1.8
Private consumption (% change)	-0.2	0.8	0.7	1.0	1.0
Gross fixed capital formation (% change)	-0.9	3.0	2.2	2.1	3.4
Exports of goods and services (% change)	2.8	4.7	4.4	5.7	5.9
Imports of goods and services (% change)	0.6	4.8	3.7	5.5	5.7
Contributions to real GDP growth:					
- Final domestic demand	-0.3	1.2	1.0	1.0	1.4
- Change in inventories	-0.7	0.3	0.1	0.3	0.0
- Net exports	1.2	0.2	0.6	0.4	0.4
Output gap[1]	-1.1	-0.8	-0.8	-0.6	-0.4
Employment (% change)	0.7	1.1	0.8	1.0	0.9
Unemployment rate (%)	4.9	5.2	4.8	5.3	4.7
Labour productivity (% change)	-0.2	0.6	1.0	0.7	1.0
HICP inflation (%)	2.1	1.9	1.6	1.9	1.7
GDP deflator (% change)	1.6	1.8	1.9	1.9	1.7
Comp. of employees (per head, % change)	2.1	2.3	2.0	2.5	2.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.6	3.3	3.4	3.7	3.8

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Updated Draft Budgetary Plan 2014 (DBP); Commission services Spring 2014 forecast (COM).

In particular, the Commission's forecast projects a somewhat more moderate recovery of domestic demand and a stronger role of net exports in 2014. In the Commission's view the improvement in business and consumer confidence is still fragile, explaining the projected modest growth of investment and private consumption in 2014 in the Commission's forecast. The Commission's forecast also projects slower employment and wage growth over 2014-15

than the updated DBP. The wage settlement pattern has in recent years reflected the evolution of productivity growth with a lag, which was negative in 2012 and 2013. Productivity growth is projected to increase moderately over 2014-15, leading to a modest increase in wage growth. Regarding employment, the Commission's forecast sees more scope to increase hours worked, rather than head-count employment. The updated DBP's macroeconomic scenario assumes stronger, migration-driven increases in the labour force, and therefore a further increase in the unemployment rate over the forecast horizon, despite more optimistic employment projections. This projection would be more consistent with lower wage increases than the ones assumed in the scenario. The two forecasts also differ in their consumer price inflation projections, most notably stemming from differing assumptions on energy prices. The two forecasts share a similar view on export growth and the external position of the economy.

The combination of these factors leads to somewhat slower increases in the tax bases for the personal income tax, social contribution and indirect taxes, somehow affecting the relative tax revenue in the Commission forecast for 2014.

Box 1: The macroeconomic forecast underpinning the budget in Austria

The DBP for 2014 submitted by Austria states that the DBP is based on the macroeconomic forecast published by the Austrian Institute of Economic Research (WIFO) on 27 March 2014.

It is a long-standing practice in Austria that the Ministry of Finance bases its fiscal plans on the macroeconomic forecast that WIFO produces four times a year following an established, pre-announced calendar. The main features of WIFO's forecasts are freely available to the public.

WIFO was founded in 1927 and benefits from a reputation as one of Austria's prominent policy oriented economic research institutes. Its analytical infrastructure and staff allow it to carry out research in a broad range of economic issues. WIFO is recognised for high-quality economic research and realistic and unbiased forecasts. It is also charged with compiling the quarterly national accounts and the business/investment surveys.

WIFO is a non-profit association under Austrian law. The 16 member Governing Board (Vorstand) and the 34 member Supervisory Council (Kuratorium) comprise representatives of various NGO's, financial institutions, including the Austrian National Bank, businesses, business associations, the academia. Representatives of the central and regional government occupy 1 and 2 seats respectively on the Governing Board and 2 seats each on the Supervisory Council.

The Scientific Advisory Board comprising 17 renowned scholars ensures the strong integration of the Institute in the international scientific community and promotes knowledge transfer of research content and methods. The board also acts as an external quality control mechanism for WIFO's activities.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The general government deficit reached 1.5% of GDP in 2013, significantly better than the target of 2.3% of GDP planned in the DBP of last October. However, this fiscal outcome was due to a large extent to the unexpected size of a one-off measure related to the sale of mobile phone spectrum, which accounted for almost 0.6% of GDP. The deficit is projected to increase in 2014 to 2.7% of GDP due to the impact of the establishment of a defeasance structure (Liquidation Entity, *Abbaueinheit*) to wind-down the impaired assets of the Hypo group Alpe Adria bank (Hypo). The impact of this measure is estimated by an expert group, appointed by the government, to amount up to EUR 4 billion (1.2% of GDP) including the effect of a capital injection of EUR 750 million, already undertaken in 2014.

The Commisison's forecast points to a general government deficit estimated at 2.8% of GDP for 2014, slightly exceeding the forecast of the updated DBP. The Commission's forecast takes into account a budgetary impact of financial sector measures which is broadly the same as the updated DBP, and takes into account specific information provided by Austria's authorities. Both estimates factor in a similar deficit-increasing impact of the establishment of the Liquidation Entity for Hypo Alpe Adria.

The final statistical recording of the deficit-increasing impact will depend on the value of liabilities incurred by the government in connection with the transfer of the impaired assets compared to their market value (or suitable equivalent). For this purpose, an independent asset quality review of Hypo's assets will be undertaken later this year in order to allow Eurostat to evaluate the fiscal impact of this operation. In the updated DBP the headline deficit is expected to decline to 1.4% of GDP in 2015, mainly reflecting the diminishing impact of one-off support to Hypo. The Commission forecast for the year 2015 is broadly in line with the government's projections.

On the revenue side, the updated DBP includes the effect of a set of measures adopted in February 2014, which amount to 0.2% of GDP in 2014 and to an additional 0.1% of GDP in 2015. The positive impact of these discretionary tax measures is, however, more than offset by less dynamic revenues from other sources. The revenue ratio is therefore projected to remain unchanged from 2013 to 2014. This is also reflected in the total amount of revenues in nominal terms being projected to be lower in 2014 by about EUR 700 million compared to what was included in the DBP submitted in October. This is in particular caused by lower indirect taxes, reflecting a lower value of the elasticities to their respective tax bases in 2013 compared to the standard value, which has been taken into account in Austria's budgetary planning for further years. In 2015 the revenue ratio is projected to decrease by 0.3 pps of GDP, also due to the withdrawal of the one-off effect of the Tax agreement with Liechtenstein in 2014 and due to the assumption of low interest rates and a rising household savings ratio weighing on consumption taxes. Thus, signalling that revenues are still projected to grow less than nominal GDP.

On the expenditure side total expenditure is projected to increase significantly in 2014 mainly due to the already mentioned impact of the establishment of the Liquidation Entity. The special treatment of inflows arising from the sale of mobile phone spectrum, recorded in 2013 as negative capital expenditure rather than revenue also impacts expenditure ratio in 2014. In 2015, the expenditure ratio is projected to decrease while nominal expenditure is envisaged to increase only marginally mainly due to lower support to the financial sector. In addition, some categories of expenditure are expected to decrease in nominal value compared to 2014. For

instance, the updated DBP projects a steady reduction in the level of subsidies, which already experienced a decline in 2013. However, judged on the basis of the information on discretionary measures reported in the updated DBP this decline might not have a structural underpinning.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014		2015		Change: 2013-2014	Change: 2014-2015
	COM	COM	DBP[1]	COM[2]	DBP	DBP	DBP
Revenue	**49,7**	**49,6**	**49,7**	**49,4**	**49,3**	**0,0**	**-0,4**
of which:							
- Taxes on production and imports	14,5	14,4	14,5	14,3	14,4	0,0	-0,1
- Current taxes on income, wealth, etc.	13,7	14,0	14,0	14,1	14,0	0,3	0,0
- Social contributions	16,7	16,6	16,7	16,5	16,6	0,0	-0,1
- Other (residual)	4,7	4,6	4,6	4,5	4,3	-0,1	-0,3
Expenditure	**51,2**	**52,4**	**52,4**	**50,9**	**50,7**	**1,2**	**-1,7**
of which:							
- Primary expenditure	48,7	49,8	49,8	48,3	48,2	1,1	-1,6
of which:							
Compensation of employees	9,4	9,2	9,3	9,1	9,2	-0,1	-0,1
Intermediate consumption	4,4	4,4	4,4	4,4	4,3	0,0	-0,1
Social payments	25,4	25,4	25,3	25,3	25,2	-0,1	-0,1
Subsidies	3,4	3,4	3,3	3,3	3,2	-0,1	-0,1
Gross fixed capital formation	1,0	1,0	1,0	1,0	1,0	0,0	0,0
Other (residual)	5,1	6,4	6,5	5,3	5,3	1,4	-1,2
- Interest expenditure	2,6	2,6	2,6	2,6	2,5	0,0	-0,1
General government balance (GGB)	**-1,5**	**-2,8**	**-2,7**	**-1,5**	**-1,4**	**-1,2**	**1,3**
Primary balance	**1,0**	**-0,3**	**-0,1**	**1,0**	**1,2**	**-1,1**	**1,3**
One-off and other temporary measures	0,1	-1,2	-1,3	-0,2	-0,3	-1,4	1,0
GGB excl. one-offs	**-1,6**	**-1,6**	**-1,4**	**-1,3**	**-1,1**	**0,2**	**0,3**
Output gap[3]	-1,1	-0,8	-0,8	-0,4	-0,6	0,3	0,2
Cyclically-adjusted balance[3]	-1,0	-2,4	-2,3	-1,3	-1,1	-1,3	1,2
Structural balance (SB)[4]	**-1,1**	**-1,2**	**-1,0**	**-1,1**	**-0,8**	**0,0**	**0,3**
Change in SB	*0,5*	*-0,1*	*0,0*	*0,1*	*0,3*	-	-
Two year average change in SB	*0,5*	*0,2*	*0,2*	*0,0*	*0,1*	-	-
Structural primary balance[4]	1,4	1,3	1,5	1,4	1,8	**0,0**	**0,3**
Change in structural primary balance		*-0,1*	*0,0*	*0,1*	*0,2*	-	-
Expenditure benchmark							
Applicable reference rate[5]	n.a	-0,12	-0,12	-0,12	-0,12		
Deviation[6] (% GDP)	n.a	-1,8	-1,6	0,5	0,6		
Two-year average deviation (% GDP)	n.a	-0,5	-0,5	-0,7	-0,5		

Notes:

[1]2013-2014 changes in the structural balances are computed on the basis of the DBP figures recalculated by the Commission.

[2]On a no-policy-change basis.

[3]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

[4]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

[5] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[6] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:

DBP: Draft Budgetary plan (DBP); Commission services 2014 Spring forecasts (COM); Commission services' calculations.

The Commission forecast is broadly in line with the government's projections both for 2014 and 2015. In 2014 the Commission projects a lower revenue ratio of 0.1% of GDP while in 2015 higher expenditure of 0.2% of GDP projected in the Commission's forecast is partly offset by a projected stronger revenue growth.

The updated DBP foresees virtually no improvement in the structural balance in 2014 (as recalculated by the Commission[2]), implying an unchanged structural deficit of 1.0% of GDP. In 2015, it foresees a reduction in the structural deficit by around 0.3 pp. The recalculated structural balance points to a lower adjustment in 2014 compared to non-recalculated figures of the updated DBP. In 2015, the recalculated structural adjustment is somewhat higher than the one presented in the updated DBP. This is due to a different computation of the output gap arising from the recalculation based on the commonly agreed methodology.

The Commission's forecast projects in 2014 a deterioration of the structural balance by 0.1%. This is mainly due to higher projected headline deficit and to a different estimated value of the one-off measures for 2014. In particular, the Commission does not include in its forecast an additional buffer for possible capital needs for other financial sector institutions, as based on information provided by the Austrian authorities. In 2015, the Commission's forecast expects the structural balance to improve by 0.1 pp. to 1.1% of GDP.

In synthesis, the updated DBP's targets for 2014 are broadly in line with the Commission forecast in terms of the headline deficit and the composition of revenue and expenditure. However, whereas the updated DBP shows virtually no improvement in the (recalculated) 2014 structural balance, the Commission's forecast indicates a deterioration of 0.1% of GDP.

3.2. Debt developments

The debt-to-GDP ratio is projected to increase by roughly 5 pps. of GDP to 79.2% of GDP in 2014. This is linked to the inclusion in general government debt of liabilities incurred in connection with the transfer of the impaired assets of Hypo Alpe Adria to the Liquidation Entity. Eurostat's guidelines for the recording of impaired assets operation envisage that both assets and liabilities of public wind-down entities have to be included in the government balance sheet and therefore public debt has to include the relevant debt instruments of the entity. Under the envisaged design of the Liquidation Entity by Austria, Hypo is expected to be converted into a public winding down unit and the assets are supposed to be transferred to this entity at their present book value alongside the transfer of liabilities of an equivalent amount. This operation contributes to a significant positive stock-flow adjustment (at 4.8 pps of GDP for 2014). Furthermore, whereas the impact on the general government deficit of the impaired assets operation is of a temporary nature, the impact on public debt is of a longer-lasting nature. The impact on public debt will fade out over time as a result of the winding-down of assets and the reimbursement of liabilities. In 2015, the updated DBP expects the debt level to decrease to 77.6% of GDP, while the Commission projects public debt at 79.2% of GDP.

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the updated DBP, using the commonly agreed methodology.

Table 3. Debt developments

(% of GDP)	Average 2008-2012	2013	2014		2015	
			COM	DBP	COM	DBP
Gross debt ratio[1]	**70,6**	**74,5**	**80,3**	**79,2**	**79,2**	**77,6**
Change in the ratio	2,8	0,1	5,8	4,7	-1,2	-1,7
Contributions[2]*:*						
1. Primary balance	**0,3**	**-1,0**	**0,3**	**0,1**	**-1,0**	**-1,2**
2. "Snow-ball" effect	**1,1**	**1,1**	**0,0**	**0,1**	**-0,2**	**-0,3**
Of which:						
Interest expenditure	2,6	2,6	2,6	2,6	2,6	2,5
Growth effect	-0,4	-0,3	-1,2	-1,2	-1,4	-1,3
Inflation effect	-1,1	-1,2	-1,3	-1,3	-1,3	-1,5
3. Stock-flow adjustment	**1,5**	**0,0**	**4,8**	**4,6**	**0,1**	**-0,2**
Of which:						
Cash/accruals diff.						
Acc. financial assets						
Privatisation						
Val. effect & residual						

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and

Source:

DBP: Draft Budgetary plan (DBP); Commission services' spring 2014 forecasts (COM); Commission services' calculations.

3.3. Measures underpinning the updated DBP

The budget for 2014 contains two consolidation packages, including measures equivalent in total to 0.4% of GDP with a roughly equivalent split between revenue increase, already adopted in February, and expenditure savings. Part of the expenditure saving measures included in the updated DBP has already been implemented in recent months.

The tax package includes measures aimed at broadening the tax base of direct taxes and at increasing indirect tax rates such as taxes on alcohol, tobacco and car taxes. About half of the total increase in tax revenue comes from consumption and environmental taxes: transport taxes (an increase of the car insurance tax and the registration tax for high powered cars) and taxes on alcohol and tobacco. Direct tax measures relate to the prolongation of the solidarity levy on holiday and Christmas bonuses for taxable incomes above around EUR 150,000 and to the deductibility of wages from CIT that will be limited to EUR 500,000 per employee.

Additional revenue by about EUR 100 million comes from measures aimed at improving tax compliance such as fighting illegal gambling and money laundering. The ability of these measures to generate the planned amount of revenue is uncertain.

Discretionary savings in subsidies implemented in 2014 are lower compared to the size of the reform of this expenditure category announced in last year Stability Programme and planned to take effect in 2015. In addition, while the updated DBP shows a continued reduction in the

level of subsidies for 2015, the table on discretionary measures, included in the same document, does not contain any additional savings for that year.

Table 4. Main discretionary measures reported in the updated DBP

A. Discretionary measures on the level of general government - revenue side			
Components	Budgetary impact (% GDP)		
	2014	2015	2016
Taxes on production and imports	0.1	0.05	0.2
Current taxes on income, wealth, etc.	0.1	0.05	0
Capital taxes	0	-0.04	0
Social contributions	0	0	0
Property income	0	0	0
Other (residual)	0	0	0
Total	0.2	0.1	0.2
B. Discretionary measures on the level of general government-expenditure side			
Components	Budgetary impact (% GDP)		
	2014	2015	2016
Compensation of employees	0.03	-0.01	0
Intermediate consumption	-0.09	0.03.	0
Social payments	-0.15	0	0
Subsidies	-0.05	0.04	0
Gross fixed capital formation	0.01	0	0
Capital transfers	0.03	0	0
Other (residual)	0	0.02	0
Total	-0.2	0.1	0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities (n.a. in case no measures have been reported). A positive sign implies that revenue / expenditure increases as a consequence of this measure.

Source:

Updated Draft Budgetary Plan 2014.

3.4. Additional measures announced by Austrian Government on 12 May

On 12 May 2014, the Austrian authorities announced their commitment[3] to take additional discretionary measures, not included in the updated DBP, that, toghether with better than expected revenue related to an improved projection for employment, amount to close to EUR 1 bn in 2014.

On the revenue side, the additional measures involve concrete actions to reduce fraud on capital gain tax, a reduction of the deducibility of costs in corporate income tax and the application of a stricter regime in relation to voluntary disclosoure of tax fraud. On the expenditure side, savings are expected from the reduction in pensions and other expenditure of semi-public companies and from streamlining the provision of subsidies and transfers in order to avoid duplications. In addition, a further reduction in discretionary spending for all expenditure categories, except items with growth-enhancing potential, are envisaged to take place by mean of a government's decision.

The Commission has evaluated the nature and possible yield of these measures. According to its assessment, those measures that are of a structural nature, have plausible yields and have an adequate legal basis could effectively amount to EUR 630 million (0.2% of GDP) in 2014, provided that they are fully implemented. At the same time, while the announced additional revenues not yet included in the updated DBP and stemming from the government's expectation of a stronger improvement in labour market conditions, cannot be considered as a discretionary measure, they constitute an upside risk to the budgetary outturn in 2014.

Table 5. Additional measures announced by the government

[3] https://english.bmf.gv.at/budget-economic-policy/Austria_s_Letter_to_EU_Commissioner_Siim_Kallas.pdf?4d4f92

Description of the measures	Austria yield estimate (EUR mln)	COM yield estimate COM (EUR mln)
Reduction of funding costs eligible for deduction; Corporate Income Tax Act	25	25
Reduction of Capital Gains Tax Fraud	50	50
Stricter regime in relation to voluntary disclosures	150	150
Better economic developments. Higher expected employment compared to the scenario of the updated DBP expected to generate additional tax revenue	300	0
Measures to increase the effective retirement age for persons having special pension regimes by enterprises with the state as shareholder	10-15 million	5,0
Reducing duplication in project and other funding between different levels of government	50	25
Expenditure savings of spun-off units	50	25
Ad-hoc reduction in discretionary spending through decision of the Council of Ministers	Up to 350	350
Total	**985**	**630**
Total (% of GDP)	**0,3**	**0,2**

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

4.1. Compliance with EDP recommendations

Austria's general government deficit turned out below the 3% reference value both in 2011 and 2012. The validated public finance data for 2013 shows that the general government deficit remained below the 3% of GDP threshold, thereby respecting the deadline set by the Council for the correction of the excessive deficit. To abrogate the EDP, the SGP requires a sustainable correction of the deficit, implying a deficit below 3% of GDP over the forecast horizon. The Commission services spring forecast covers 2014 and 2015 and projects a sustainable correction as the deficit remains below the 3% of GDP threshold in both years. The deficit-increasing impact of the Liquidation Unit is still provisional, since it is based on a report made by an expert group appointed by the Government. Even if the estimate can be considered prudent and has been subject to an opinion by the Statistical Office of Austria that was associated to the work of the expert group, the final validation of the statistical impact of this operation will be made by Eurostat on the basis of an asset quality review made by an independent body. Other sources of risks relates to slippages in public expenditure or lower revenue, for instance from the revenue expected to be raised from the tax agreement with Liechtenstein. However these slippages are likely to remain within the size of the budgetary buffer up to the threshold of 3% in 2014. Also, the government would have the possibility to take compensatory measures before the end of the year to offset possible minor slippages in the deficit to secure the sustainability of the correction.

Box 2. Council recommendations addressed to Austria

On 2 December 2009, the Council decided that an excessive deficit existed in Austria and adopted a Council Recommendation under Art. 126(7) TFEU. The Council recommended Austria to correct its excessive deficit by 2013. To this end, Austria should: bring the general government deficit below 3% of GDP in a credible and sustainable manner; ensure an average annual fiscal effort of ¾% of GDP over the period 2011-2013, which should also contribute to bringing the gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus.

On 9 2013 July, the Council also addressed recommendations to Austria in the context of the European Semester. In particular, in the area of public finances the Council recommended to Austria to implement the 2013 budget as envisaged and to attain the MTO by 2015.The Council also recommended to harmonise the pensionable age between men and women and to link retirement age to life expectancy.

4.2. Compliance with the debt criterion

Under the assumption that the EDP is abrogated, Austria will be in transition period under the debt rule as from 2014 and will have to make sufficient progress towards compliance with the debt criterion.

A "transition period" applies to countries that were in EDP on 8 November 2011. It starts the year after the correction of the excessive deficit. During the transition period Member States are required to make sufficient progress towards the debt reduction benchmark, defined by the minimum linear structural adjustment. If Austria is abrogated on the basis of notified data for 2013, it will be subject to the transition period in 2014 and 2015. Thereafter, i.e. from 2016, Austria should show a debt-to-GDP ratio fully compliant with the debt benchmark, i.e. sufficiently diminishing towards the 60% reference value.

According to the SGP Code of Conduct, the **"**minimum linear structural adjustment**"** is the linear structural adjustment ensuring that – if followed – Member States will comply with the debt reduction benchmark at the end of the transition period. This minimum linear structural adjustment path will be built taking into account both the influence of the cycle and the forward-looking nature of the debt benchmark. Also, in order to ensure continuous and realistic progress towards compliance during the transition period, Member States should respect simultaneously the following "double condition":

1. The annual structural adjustment should not deviate by more than ¼% of GDP from the minimum linear structural adjustment.

2. At any time during the transition period, the remaining annual structural adjustment should not exceed ¾% of GDP. This condition does not apply in case the first condition implies an annual effort above ¾% of GDP.

Table 6. Compliance with the debt criterion

	2014		2015	
	DBP[1]	**COM**[2]	**DBP**[1]	**COM**[2]
Gap to the debt benchmark[3,4]		n.r.		n.r.
Structural adjustment[5]	0.0	-0.1	0.3	0.1
To be compared to:				
Required adjustment[6]	-0.2	-0.2	-0.3	-0.3

Notes:

[1]Assessment of the consolidation path set in the DBP assuming growth follows the DBP projections.

[2]Assessment of the consolidation path according to the COM forecasts

[3] Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[4] Shows the difference between the debt-to-GDP ratio (80.3 in 2014 and 79.2 in 2015) and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[5] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that was ongoing in November 2011.

[6] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Commission services Spring 2014 forecast (COM)*; Commission services calculations.*

According to both DBP's projections and the Commission's forecast the minimum linear structural adjustment satisfying the debt criterion would be respected even with a deterioration of the structural balance of 0.2% of GDP in 2014 and 0.3% of GDP in 2015. Hence, both the change in the structural balance projected by the DBP and the Commission forecast ensure the respect of the debt criterion in 2014 and 2015.

1.1. Compliance with the required adjustment towards the MTO

Under the assumption that the EDP is abrogated, Austria will be subject to the preventive arm of the SGP as from 2014 and should ensure sufficient progress towards its MTO. With a debt ratio above 60% and normal cyclical conditions (the output gap falls in the interval between -1.5% and 1.5% of GDP), Austria is required to pursue an annual structural adjustment toward the MTO of above 0.5% in 2014, which has been operationalized in consultation with Member States as a requirement of an effort of at least 0.6% of GDP.

Article 5.1 of Regulation 1466/97 stipulates that "sufficient progress towards the medium-term objectives shall be evaluated on the basis of an overall assessment with the structural balance as reference, including an analysis of expenditure net of discretionary revenue

measures. Furthermore, the Regulation sets thresholds for significant observed deviation based on one-year figures as well as on two-year averages.

The updated DBP (as recalculated by the Commission services using the common methodology) envisages virtual no improvement in the structural balance implying an unchanged structural deficit of 1.0% in 2014, falling short of the 0.6% of GDP required adjustment. The deviation even exceeds the 0.5% threshold for a significant observed deviation as set out in Regulation 1466/97. The Commission's forecast projects a negative structural effort of 0.1% of GDP. This difference is due to a different estimation of one-off measures made by the Commission and to a larger headline deficit projected for 2014.

According to the information provided in the updated DBP, the growth rate of government expenditure, net of discretionary revenue measures is not expected to be consistent with an annual structural improvement of 0.6% of GDP in 2014. The growth rate of this expenditure is above which is the lower rate of expenditure growth allowed under the expenditure benchmark in the case of Austria (-0.1%) and contributes to a deviation from the expenditure benchmark by around 1.6% of GDP. This is due essentially to the cost of establishing the planned Hypo Alpe Adria defeasance structure and other planned financial sector measures, since such expenditure-increasing one-offs are not excluded from the expenditure benchmark, while they are excluded from the structural balance. The expenditure benchmark computed by the Commission on the basis of its forecast projects a deviation by 1.8% of GDP.

In 2015, the annual structural adjustment computed on the basis of the recalculated structural balance of the DBP is projected at roughly 0.3% of GDP, which is larger than the estimate of the updated DBP (0.1% of GDP). This is due to the fact that the Commission's recalculation made on the basis of the common methodology takes into account a larger output gap in 2015 than in the updated DBP. The Commission forecast projects an improvement in the structural balance by 0.1% of GDP due to a smaller output gap and a higher headline deficit. In 2015, the growth rate of expenditure set out in the updated DBP is projected to be below the lower rate under the expenditure benchmark (-0.1%).

On 12 May 2014, the Austrian government reiterated its commitment to the 5 May Eurogroup to take additional measures as appropriate to avoid a significant deviation in Austria’s structural effort for 2014. It publicly announced, and confirmed in a letter to the Commission, a set of additional revenue and expenditure measures amounting to close to EUR 700 million in 2014. Due to better-than-expected economic developments the Austrian government also projects higher revenues by EUR 300 million from social security contributions and income tax compared to the DBP's projections. According to its assessment, the Commission is of the opinion that the package includes structural measures of about EUR 630 million, or 0.2% of GDP in 2014. These measures, if fully and timely implemented, should thereby reduce the planned deviation from the required adjustment path towards the MTO in 2014 from 0.6% to 0.4% of GDP. However, implementation risks exist, especially in relation to the expenditure-reducing measures. In particular, the government will have to take the necessary actions in order to achieve the full amount of savings planned through the reduction of discrentionary spending in order to achieve the envisaged structural adjustment of 0.2% of GDP.