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Recommendation for a

COUNCIL RECOMMENDATION

**on the 2019 National Reform Programme of Austria and delivering a Council opinion on
the 2019 Stability Programme of Austria**

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Austria as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the recommendation on the economic policy of the euro area ('Recommendation for the euro area').
- (2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Austria should ensure

¹ OJ L 209, 2.8.1997, p. 1.

the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (1) to (3) below. In particular, focusing economic policy related to investment in the specified areas will help address the second euro area recommendation as regards supporting investment, while the recommendation to shift taxes away from labour addresses the third euro area recommendation regarding functioning of the labour market.

- (3) The 2019 country report for Austria² was published on 27 February 2019. It assessed Austria's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and Austria's progress towards its national Europe 2020 targets.
- (4) On 24 April 2019, Austria submitted its 2019 National Reform Programme and its 2019 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council³, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance⁴.
- (6) Austria is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2019 Stability Programme, the government expects that the headline balance will improve from a surplus of 0.1% of GDP in 2018 to 0.3% of GDP in 2019 and incrementally reduce to a balanced budget position in 2023. Based on the recalculated structural balance⁵, the medium-term budgetary objective – a structural deficit of 0.5% of GDP – continues to be overachieved throughout the programme period. According to the Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 73.8% of GDP in 2018 to 59.8% of GDP in 2023. The macroeconomic scenario underpinning those budgetary projections is favourable. The risks underlying the medium-term budgetary planning appear to be moderate and mainly concern the announced implementation of cost savings in the public administration that are to be used to finance the planned reform of the personal and corporate income tax.
- (7) On 13 July 2018, the Council recommended Austria to achieve the medium-term budgetary objective in 2019, taking into account the allowance linked to unusual events for which a temporary deviation is granted. This is consistent with a maximum

² SWD(2019) 1019 final.

³ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

⁴ COM(2014) 494 final.

⁵ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

nominal growth rate of net primary government expenditure⁶ of 2.9%, corresponding to an improvement in the structural balance by 0.3% of GDP. Based on the Commission 2019 spring forecast, the structural balance is forecast to improve from -0.1% of GDP in 2019 to 0.0% of GDP in 2020, above the medium-term budgetary objective. Austria is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that Austria is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.

- (8) Austria faces medium fiscal sustainability risks in the long term. These risks are due to the projected increase in public expenditure on healthcare, long-term care and pensions. While coverage of healthcare services is generally high in Austria, public healthcare expenditure is projected to increase by 1.3 pps to 8.3% of GDP by 2070 and hence more than the EU average of 0.9 pps. Public expenditure on long-term care is projected to double from 1.9% to 3.8% of GDP by 2070. The introduction of expenditure ceilings through the 2017 Financial Equalisation Law and the Primary Health Care Reform, aimed at reducing the excessive reliance on the hospital sector, have started to address the sustainability issue. The recently adopted Social Security Organisation Act may entail savings in governance and administrative costs but will generate upfront costs. Quality and cost-efficiency would be further helped by more effective public procurement (e.g. EU-wide tendering, the use of award criteria other than price, and aggregating tenders across regions) and a wider use of e-health solutions. In the area of long-term care, recent policy measures - such as the decision to abolish the obligation on patients to use their own private assets to fund long-term inpatient care - are expected to increase, rather than contain, expenditure.
- (9) Pension spending would peak in 2036, at a level of 1.2 pps of GDP above the 2016 reference point. Past reforms have successfully provided incentives to retire later (the effective exit age from the labour market increased by an estimated 1.5 years for men and by 1 year for women between 2014 and 2017). However, closing the gap between the statutory and the effective retirement age remains a challenge and longer working lives should be promoted. In addition, adjusting the minimum age for both early and statutory retirement would help improve long-term sustainability more effectively in the context of an ageing society. Introducing an automatic link between the statutory retirement age and gains in life expectancy in the future could reduce public pension expenditure. Such a reduction is estimated to 2.4 pps of GDP in 2016-2070, thus offsetting the increase that would be the result of an unchanged policy.
- (10) Austria's fiscal federalism leads to a significant mismatch in expenditure and revenue-raising responsibilities at subnational level. Rather than relying on tax autonomy, subnational budgets are fed by a complex system of tax sharing and intergovernmental transfers. This hampers both fiscal transparency and political accountability, and provides few incentives for efficient public spending. The 2017 Intergovernmental Fiscal Relations Act has introduced a series of changes to streamline the fiscal relations between the different levels of government. The changes include simplifying the distribution of shared taxes, assigning an own source of revenue to the *Länder*, and agreeing on further reforms for a more transparent allocation of legislative and

⁶ Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

executive responsibilities between levels of government. As for the latter, the *Kompetenzvereinigungspaket* constitutes a first step towards the disentangling responsibilities as it re-allocates shared policy areas to either (exclusively) the federal or the *Länder* level, and reduces mutual rights of assent. However, the law affects only a limited number of policy areas.

- (11) Austria's tax structure is characterised by a high burden on labour (payroll taxes and social security contributions). The burden is set to increase over time, as long as tax brackets are not indexed to inflation. At 55.3% in 2017, the share of labour taxes in total tax revenue was one of the highest in the EU (average: 49.7%). Recent reforms, such as reductions in social security contributions for low-income earners and employers as well as the tax relief for working parents provided by the new Family Bonus plus, have helped lower the labour tax wedge. There remains scope for shifting the tax mix towards sources that support more inclusive and sustainable growth. In particular, recurrent property taxes are found to be relatively growth-friendly and progressive, as higher-income earners are likely to possess more housing wealth. However, due to a largely outdated tax base, revenue from recurrent property taxes in Austria remains low and well below the EU average. A revaluation of the tax base would help generate more revenue and address fairness issues that arise when land/real estate values are decoupled from market prices. Effective, well-designed wealth-related taxes could also make the tax system fairer, especially against the background of Austria's striking wealth inequality and in the absence of inheritance and gift taxes. Finally, environmental taxes help internalise negative externalities of resource use and polluting activities related to health and climate. In this context, the preferential tax treatment such activities currently enjoy should be reconsidered.
- (12) The labour market is improving; however, the untapped potential of human capital is hampering productivity and long-term growth with changes particularly required for women, low-skilled workers, older workers and people with a migrant background. Despite an overall high employment rate for women (Austria 71.7% vs. EU 67.4% in 2018), the number in full-time employment remains rather low. Female part-time employment is well above the EU average (Austria 47.6% vs. EU 30.8% in 2018) and is mainly related to insufficient childcare facilities and a high share of women performing unpaid care tasks. The current design of childcare services provision and family-related leave do not sufficiently contribute to equal opportunities for men and women on the labour market. Further investment in affordable full-time childcare services and all-day schools would help more women work full-time, better use the labour market potential of women, and improve productivity and long-term inclusive growth. Female part-time employment also explains an important share of the unadjusted gender pay gap, which remains visibly above the EU average (Austria 19.9% vs. EU 16.0% in 2017). Other important drivers of this gap are the over-representation of women in low-paid sectors, segregation related to the choice of education, under-representation of women in management and supervisory positions, and career breaks. Overall, the substantial gender gap in pension income (Austria 40.5% vs EU 35.2%, in 2017), is largely the result of these gender-specific income inequalities generated during working life. Moreover, marginally employed people, a majority of whom are women, are not covered by unemployment benefit. High unemployment rates among the low skilled point to underused labour market potential. More than 44% of all unemployed have completed only basic schooling (up to lower secondary school, '*Pflichtschule*'). Active labour market policies encouraging more people to work or look for a job, including lifelong learning opportunities, remain crucial for realising the labour potential of workers with a migrant background and

low-skilled adults. The involvement of social partners in the decision-making process for these policies, despite being traditionally strong, has been challenged.

- (13) Shortages of skilled labour point to the need to invest more in general education and training. Learning outcomes for disadvantaged students have not improved. A wide performance gap remains between students with and without a migrant background. National testing in 2016 showed that the level of basic skills poses a challenge, as around one-quarter of 8th grade pupils do not or only partially meet educational standards in German. Results for those with a weak socio-economic and/or migrant background have hardly improved in national testing. Recent international testing also confirmed a widening gap in reading for those from a lower socio-economic or migrant background. In the Programme for International Student Assessment, Austrian-born pupils outperform first generation migrants by a level equivalent to almost three years of schooling. Recent education reforms partly undermine previous reform efforts and are not in line with EU and OECD best practice. In this context, the expansion of all day schooling has slowed, and tracking and streaming in general school is being intensified. Investment is required to address unequal education outcomes due to socio-economic or migrant background. While Austria performs above average in the EU with regard to the digital skills of its citizens, it is falling behind the top performing countries. There is a growing lack of skilled IT workers in the economy, as increasing demand is not met by a sufficient supply of computing graduates.
- (14) Austria is a country that invests heavily in research and development, with ambitious national targets. However, the scientific and innovation outputs are not at the level of those of EU's 'Innovation Leaders'⁷. Increased investment in research and development do not translate entirely into innovation outcomes and productivity growth. In particular, Austria performs poorly on employment in fast-growing innovative firms. Research and development investment would be more effective if it was translated fully into excellent science and ground-breaking innovation. To do so, more and better links between science and business should be enabled and cooperation on smart specialisation priorities between different regions and with other countries should be encouraged. In addition, further investment could generate major productivity gains and innovation outcomes including into eco-innovation, the innovation capacity of small and medium-sized enterprises and in complementary intangible assets.
- (15) While Austria performs better than the EU average in overall progress with digitalisation, it does not reach the level of EU's 'Innovation Leaders'. This concerns the use of digital technologies but also their development. Austria's information and technology sector is comparatively small and has not been subject to the same growth as similar sectors in the 'Innovation Leader' countries. Additionally, rural areas lack high-speed connectivity, which increases the divide in digitalisation and innovation capacities between regions. Significant gaps also exist as regards digital infrastructure in schools, for example for the coverage of wireless local area networks. A relaunch of Austria's overall digitalisation strategy offers an opportunity to adopt targets and indicators and also to monitor progress on the necessary public and private investment in digitalisation.

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As defined by the European Innovation Scoreboard 2018 – *Innovation leader*: SE, DK, FI, NL, UK, LU
Strong innovator: DE, BE, IE, AT, FR, SI.

- (16) Increasing energy efficiency and the share of renewable energy resources would strengthen Austria's sustainable growth potential and help meet the country's climate and energy targets for 2030. Available solutions are used only sporadically, and public investment in research and development in the area of environment and energy is below the EU average. Improving energy efficiency and the use of renewable energy in small and medium-sized enterprises would help reduce energy consumption. Investment in building renovation, renewable electricity generation and sustainable mobility could provide a significant boost to the Austrian economy. A transition towards a circular economy requires an overall strategy and increased investment by businesses.
- (17) Despite a recent uptick linked to the favourable economic climate, Austria has not yet managed to rekindle total factor productivity growth and to leave behind the decade-long stagnation in this key driver of economic growth and competitiveness. Levers to support productivity growth relate to the digitalisation of businesses, company growth and competition in services. While Austria's larger businesses are adopting digital technologies and business models at a good pace, its smaller businesses lag behind. Digitalisation of smaller firms, including micro-enterprises, is particularly important, as they form the backbone of the Austrian economy. The considerable take-up of the programme '*KMU Digital*' shows demand and interest among small and medium-sized enterprises in getting advice on digitalisation. Prolonging and expanding this programme would help, as well as further policy focus on business digitalisation under Austria's overall digitalisation strategy.
- (18) Structural challenges remain for starting and scaling-up businesses in Austria, and in particular highly innovative companies. Austria lags behind comparable EU countries as regards employment in fast-growing innovative firms. This points to a need to improve the conditions for scaling up innovative businesses, which remains hindered by factors such as a venture capital landscape that is less developed and diverse than in 'Innovation Leader' countries. Later-stage funding, such as in the forms of venture capital and access to public capital markets for scale-ups, is a bottleneck. The newly created small and medium-sized enterprises segment on the Viennese Stock Exchange is a step in the right direction. High-growth companies are crucial for spreading new technologies and business models, including digital ones, and thus for productivity growth.
- (19) Austria has significant access barriers and restrictive rules on the exercise of business services and regulated professions. These include specific shareholding requirements, extensive reserved activities and interdisciplinary restrictions. Regulatory barriers, notably as regards the daily operation of shops, contribute to the relatively weak development of Austria's retail sector. A high administrative burden remains a pressing concern for Austria's businesses. Continued efforts to reduce burdens and the planned evaluation of Austria's Trade Licence Act (*Gewerbeordnung*) are important instruments to improve the business environment. More competition in the service sector would also help address Austria's challenges in spreading digital technologies and business models.
- (20) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report⁸. This would allow Austria to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

⁸ SWD(2019) 1019 final.

- (21) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Austria's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Austria in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Austria, but also their compliance with Union rules and guidance. This reflects the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (22) In the light of this assessment, the Council has examined the 2019 Stability Programme and is of the opinion⁹ that Austria is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that Austria take action in 2019 and 2020 to:

1. Ensure the sustainability of the health, long-term care, and pension systems, including by adjusting the statutory retirement age in view of expected gains in life expectancy. Simplify and rationalise fiscal relations and responsibilities across layers of government and align financing and spending responsibilities.
2. Shift taxes away from labour to sources more supportive for inclusive and sustainable growth. Support full-time employment among women, including by improving childcare services, and boost labour market outcomes for the low skilled, in cooperation with the social partners. Raise the levels of basic skills for disadvantaged groups, including people with a migrant background.
3. Focus investment-related economic policy on research and development, innovation, digitalisation, and sustainability, taking into account regional disparities. Support productivity growth by stimulating digitalisation of businesses and company growth and by reducing regulatory barriers in the service sector.

Done at Brussels,

*For the Council
The President*

⁹ Under Article 5(2) of Council Regulation (EC) No 1466/97.