



## OECD ECONOMIC SURVEY OF AUSTRIA 2003: MEDIUM-TERM CHALLENGES

*This is an excerpt of the OECD Economic Survey of Austria, 2003, from the section on recent macroeconomic developments and medium-term issues, chapter 1.*

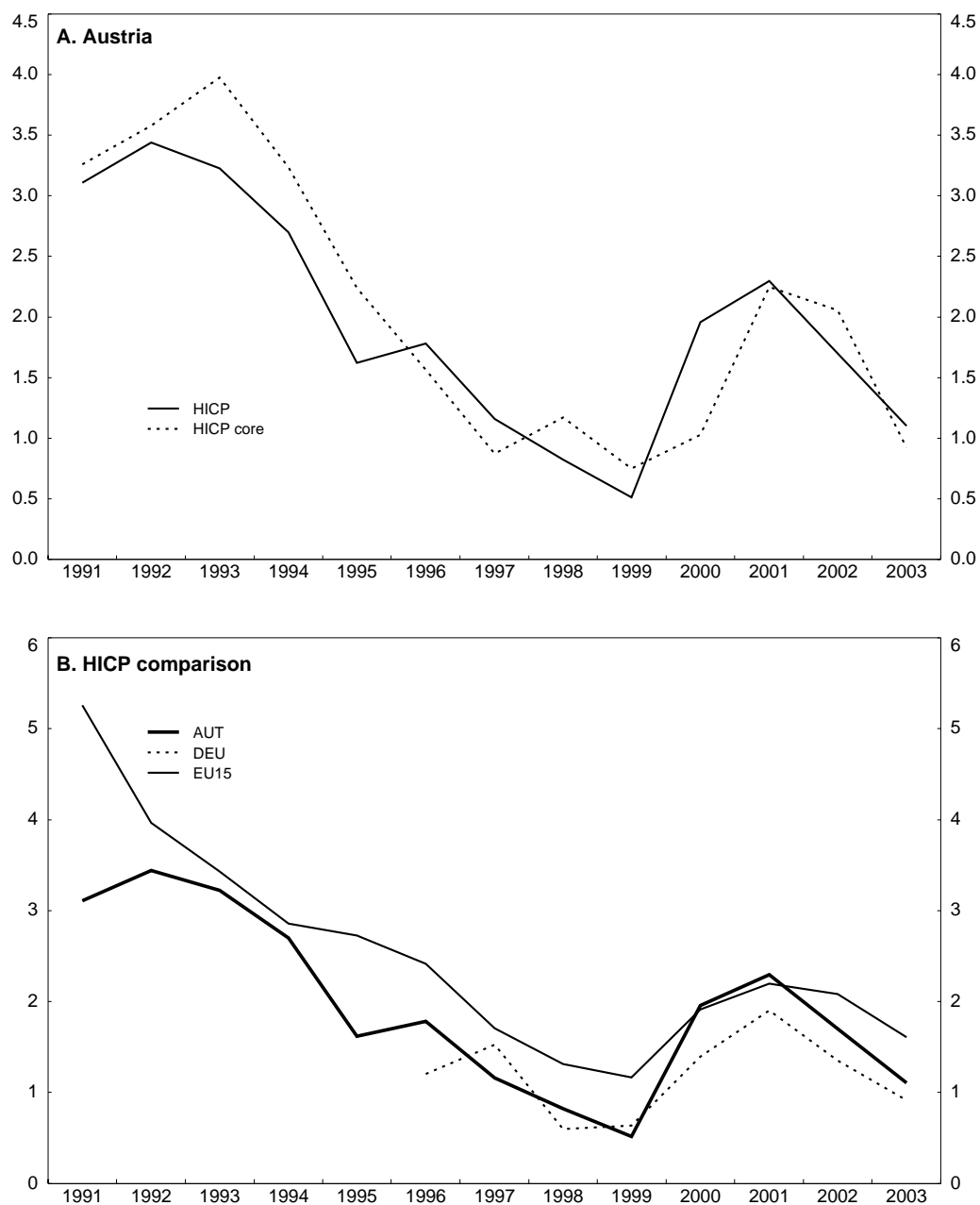
### Medium-term challenges

#### *Relative growth has slowed since the middle of the 1990s*

Over the 1980s Austrian average per capita growth of real GDP roughly equalled that of the smaller European Union countries with the highest per capita income, averaging some 2 per cent per year (Figure 3, Panel A). While a positive growth differential in favour of Austria opened up at the end of the decade and into the 1990s, since the middle of the 1990s Austrian growth per capita has on average been somewhat below that of the other high-income countries (Figure 3, Panel A). To some extent the impetus to activity at the beginning of the last decade was driven by the German reunification boom, which temporarily boosted Austrian exports to its main trading partner.<sup>1</sup> Thereafter, fading exports to Germany were largely compensated by accelerating Austrian exports to other countries, notably outside the European Union, and this has continued to stabilise Austrian economic activity in the present phase of the business cycle, as highlighted above. The opening of the Eastern European economies, followed by high growth in the area, has been particularly important for Austrian exports, supported by the improvements in Austria's international competitiveness. The share of exports directed to non-EU countries increased from 32 per cent in 1991 to 40 per cent in 2002, with the share directed to eastern European countries doubling from 7 to 15 per cent. In the second half of the 1990s exports – as opposed to domestic demand – became the main contributor to Austrian GDP growth (Figure 3, Panel B). Indeed, the weakening of Austria's relative growth performance *vis-a-vis* other smaller EU countries since the second half of the 1990s is driven more by weaker domestic demand rather than by subdued exports. Reduced resilience of domestic demand increases the vulnerability of the economy to external shocks such as the recent appreciation of the Euro, and reinforces the need for structural reform so as to raise growth potential.

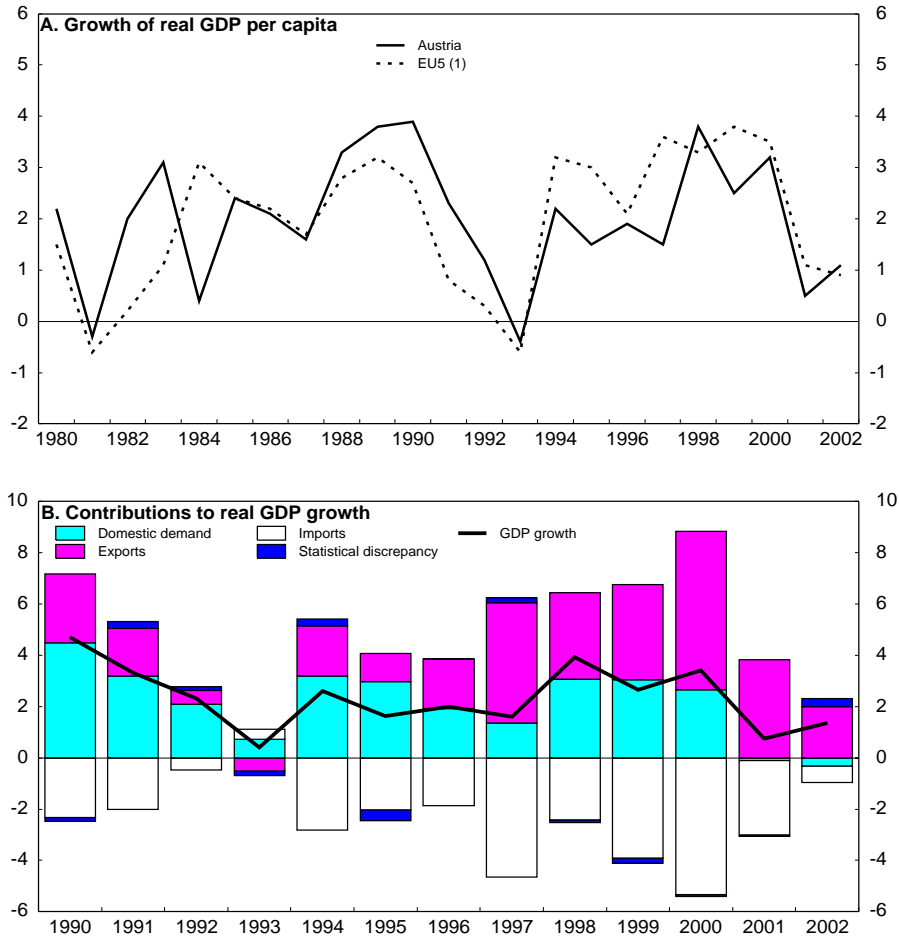
A decomposition of real per capita growth into the growth contributions of labour -- in terms of total hours worked per inhabitant -- and labour productivity -- in terms of real GDP per hours worked -- indicates that the weaker growth performance in the second half of the 1990s relative to other high-income countries is accounted for by more subdued employment growth. Since 1995, total hours worked per inhabitant did not contribute to real GDP growth per capita, while it contributed 0.7 per cent to growth in the high-income EU countries and 0.2 per cent in the United States, respectively.<sup>2</sup> At the same time labour productivity on an hourly basis grew faster than in some EU countries, but not fast enough to compensate for the adverse impact on growth of the weaker labour input.

**Figure 2. Inflation developments (1)**  
Per cent



1. Data for 2003 is for January to June. HICP is the Eurostat harmonised index of consumer prices. HICP core is all items except food, alcohol, beverages, tobacco and energy. EU15 includes all member countries except Ireland and Luxembourg from 1993 on. Before 1993 EU15 includes a minimum 66% of the country weight. Germany is included in the total throughout. Source: Eurostat; OECD Main Economic Indicators.

**Figure 3. Growth developments**  
Per cent



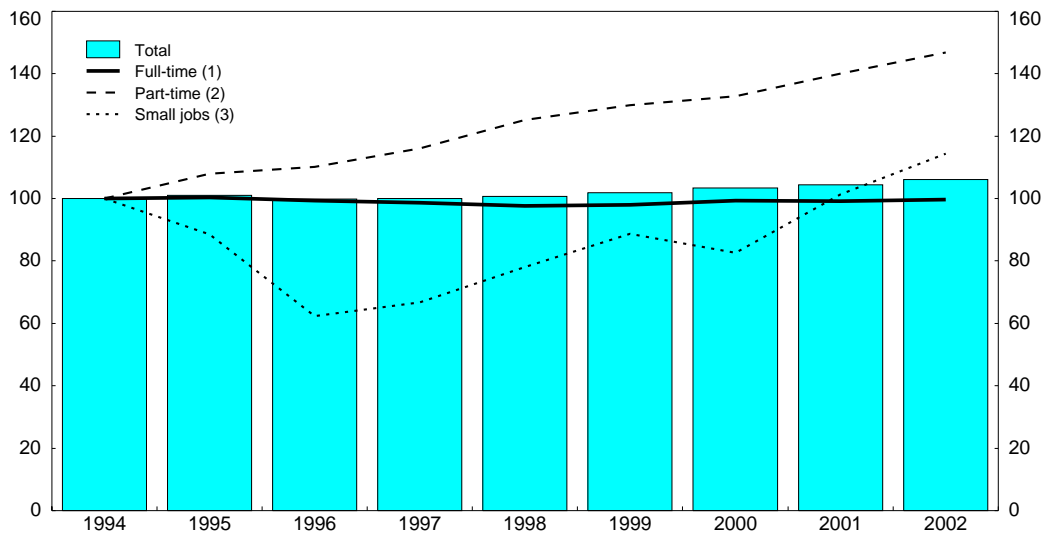
1. DNK, BEL, NLD, SWE, IRL selected from the EU (excluding AUT, LUX, DEU, FRA) on the basis of the highest average GDP per capita level in 1995 prices and PPP, 1991-2002. The EU5 growth rates are weighted averages of country growth rates, weights as in the OECD Economic Outlook.

Source: OECD - Economic Outlook Database and Annual National Accounts.

### *Employment generation is below its potential*

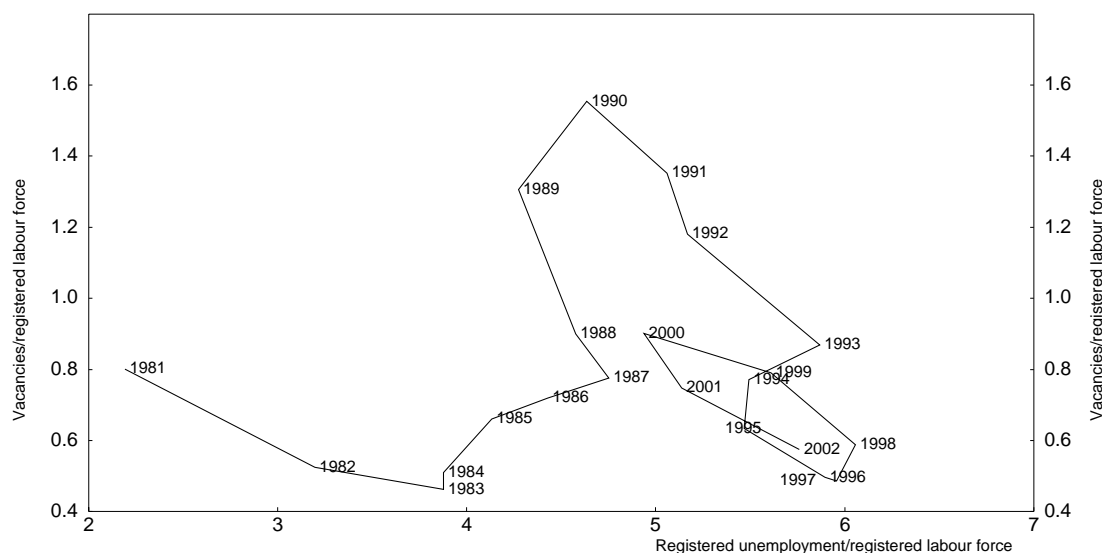
Over the last several years Austria experienced a significant increase in the share of part-time employment, as did other OECD countries, although the share is still below the OECD average. To a large degree, this reflects a secular increase in female labour force participation and the growing share of the service sector in total value added, which accounts for the largest part of part-time jobs. In particular, small jobs with only very few hours worked per week – being subject to a more favourable tax regime – have been growing at an increasing rate.<sup>3</sup> Consequently, average hours worked per employee have dropped. However, full-time employment has hardly maintained the level that prevailed in the middle of the 1990s (Figure 4). Moreover, the ratio of job vacancies to unemployment (Beveridge curve) has risen since the 1980s, although more recently some bounce back appears to have occurred (Figure 5). Compared with the beginning of the 1980s, this indicates a secular increase in the mismatch between job slots and labour supply in a period with increasing market pressure for structural change. A number of adverse factors are likely to have contributed to these developments, notably barriers to labour force participation, disincentives for labour demand and low competition in some areas of the economy.

**Figure 4. Employment by type**  
1994 = 100



1. Full-time is 37 to 40 hours inclusive per week.  
2. Part-time is 12 to 36 hours inclusive per week.  
3. Small jobs, comprising only primary jobs, are less than 12 hours per week.  
Source: Statistics Austria, Microcensus: OECD

**Figure 5. Development of unemployment to vacancies ratio (1)**



1. Registered labour force is civilian employment plus registered unemployment.  
 Note: series breaks in labour force data (due to employment component) at 1981/82, 1983/84, 1993/94.  
 Source: OECD - Labour Force Statistics and Main Economic Indicators.

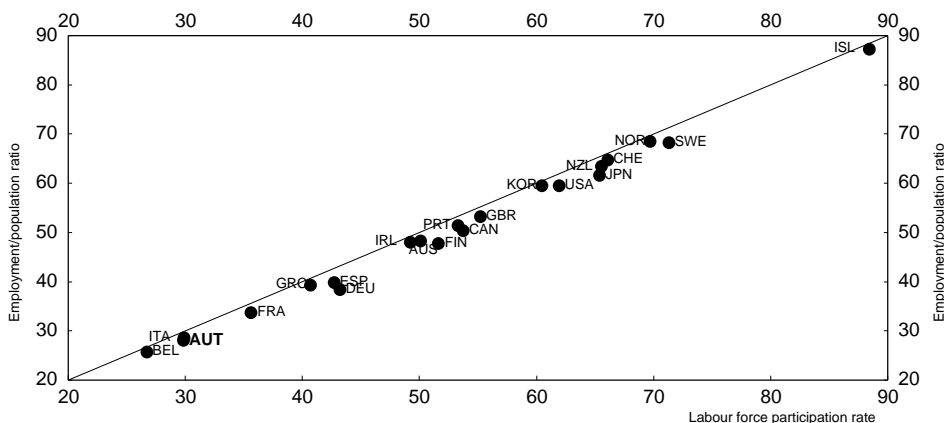
**... with labour force participation of the older people being very low**

Discouraging labour force participation of older people has been a deliberate choice by policy makers over many years for the purpose of reducing unemployment, as was also the case in some other European countries. The main approach was to ease various channels into effective early retirement. At the same time, Austria is subject to strong demographic pressures that interact with the disincentives for labour force participation. Between 1990 and 2000 the rising share of older people in the total population already affected aggregate labour force participation more negatively than in almost all other countries in the OECD.<sup>4</sup> Overall, Austrian employment rates of older people are very low by international comparison. Only 27½ per cent of the population aged between 55 and 64 years are employed, placing Austria at the lower end within the OECD, whose employment ratio for older people averages some 53 per cent, with some countries significantly exceeding the average. The low employment rate for older people is mirrored in an equally low labour force participation rate for the same age group, which stands at 29 per cent as opposed to 55 per cent at the OECD average.

With fiscal pressure in the Austrian pension system mounting, the early retirement approach was partially revised, and measures were taken to curb entry into early retirement in the old age pension system. But there is still a perception in the society that economic growth is not high enough to prevent higher labour supply from translating into higher unemployment. However, while discouraging labour force participation might temporarily reduce statistical unemployment rates it also has a negative impact on job creation. What is required is reducing impediments to both higher labour supply and the firms' labour demand, so that higher volumes of employment contribute in turn to stronger economic growth and

incomes. Indeed, massive early retirement in Austria did not prevent the secular increase in the registered unemployment rate among workers aged 55 and older being significantly above the national average<sup>5</sup>. By contrast, in OECD countries where participation rates of older workers are high, so are their employment rates suggesting few inherent barriers to employment at an old age (see Figure 6).

**Figure 6. Participation and employment rates for 55-64 year olds, 2002 (1)**  
Per cent



1. Participation and employment rates are, respectively, labour force and employment of 55-64 year olds divided by population aged 55-64.

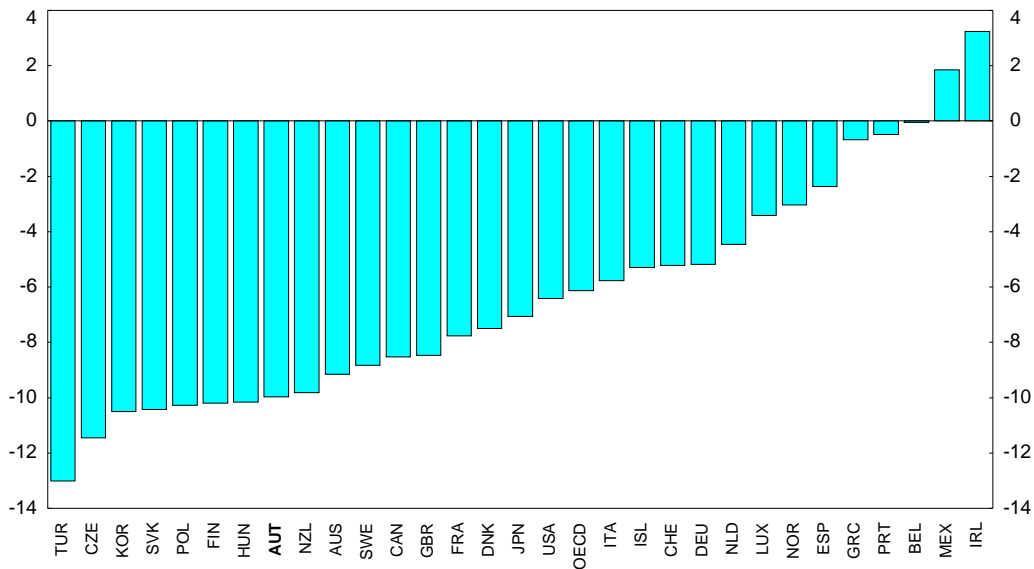
Source: OECD - Labour Force Statistics, for EU member countries data is from the European Labour Force Survey.

Moreover, with the share of older people set to increase dramatically over the next years and decades to come, Austrian aggregate labour force participation would drop even further without policy action. Simulations by the Secretariat indicate that the demographic effect alone -- assuming all other things unchanged -- would instigate a drop in Austria's participation rate by some 10 per cent until the year 2030. This deterioration is in the upper range within the OECD, and - without further policy action -- would profoundly restrain GDP growth per capita and burden the social systems with new demands (Figure 7).

**... reflecting significant disincentives to labour force participation of older people**

One clear reason for low participation of older workers is the low effective retirement age. In 2001 the average entry-age into retirement -- both old age and invalidity -- stood at 58.7 years for males and 57.3 years for women. Since 1970 the retirement age has dropped by 3.2 and 3.1 years for males and females respectively, despite the secular increase in life expectancy.<sup>6</sup> According to OECD estimates, the effective retirement age for males and females in Austria stands within the lower quintile among the OECD.<sup>7</sup> At the same time Austria is close to the top in the OECD with respect to spending on pensions as a share of GDP, totalling some 10½ per cent net of pensions for civil servants, and some 14½ per cent with the scheme for civil servants added on. While earlier pension reforms sought to address these issues they remained partial. The government has recently tabled more fundamental pension reform legislation (see Chapter II below).

**Figure 7. The demographic impact on labour force participation rates, 2000-2030, % (1)**



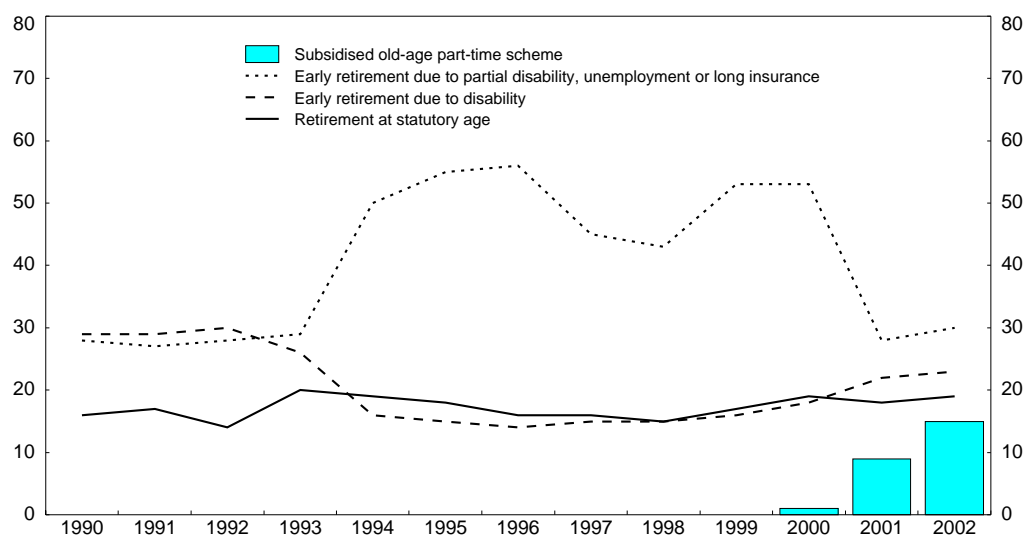
1. Projected participation rate for 2030 (based on demographic developments only) minus participation rate for 2000. Participation rate is labour force aged 15 years or more divided by population aged 15 years or more.  
 Source: OECD, Taxing wages.

Some other features in the tax and transfer system also discourage labour force participation by older people. This is notably true for the old-age part time scheme, which subsidises compensation for older people provided they reduce their working time from full-time to part-time employment (*Altersteilzeit*). In particular, participants are allowed to allocate “part time work” so as to work full-time during the first years covered by the scheme and cease working in the remainder of this period. While the instrument is intended to make it more attractive for older people to stay in the labour market its actual impact appears to be just the opposite. Previous *Surveys* pointed to the scheme’s disincentives for labour supply, which is reinforced by the interaction with early retirement provisions in the pension system. On the labour demand side, the instrument effectively allows firms to scale down the employment of the older people at the expense of the social security budget so as to avoid rising labour costs associated with seniority.

The scheme was also justified by the hope that reduced participation of older workers would increase hiring of unemployed younger workers and new entrants. In fact, the *Altersteilzeit* scheme has failed to deliver increased hiring of younger people. This is apparent from the fact that the scheme was hardly utilised in its original version which required new hiring of unemployed or apprentices as a precondition for the subsidisation of working time reductions of older employees. However, since this condition was given up in October 2000 the scheme was used at increasing rates as an exit channel into effective early retirement. Between 2000 and 2001 inflow into *Altersteilzeit* increased by more than 550 per cent, and by another 70 per cent in 2002 (Figure 8). About two-thirds of the participants work full-time in the first years of the admissible time span and cease working in the second part.<sup>8</sup> The government is now reforming the scheme. The fact that utilisation of the *Altersteilzeit* scheme accelerated at a time when inflow into early retirement within the pension system has been retrenched illustrates the

need to tighten simultaneously eligibility conditions for income replacing benefits across all potential channels into effective early retirement.

**Figure 8. Inflow into early retirement and the subsidised old-age part-time scheme**  
Thousands



Source: Arbeitmarktservice Österreich and Hauptverband der Sozialversicherungsträger.

***... while labour force participation for women is coming under pressure***

Female labour force participation is somewhat above the OECD average, and has increased over the last years. However, the change in the age distribution in Austria's society would substantially reduce female labour force participation if age specific participation rates for women remain unchanged. While family support policies target a number of goals that might be considered non-economic, they also have an impact on female labour force participation and employment. Social transfer schemes that discourage parents from participating in the labour market may be costly beyond their immediate fiscal impact for the society as a whole. Over the last years Austria has given a high weight to extending financial support to families, with the most recent extension of family benefits having occurred in 2002, placing Austria within the top range of the OECD with respect to the level of resources devoted to family support. However, in some respects the transfer system appears to imply disincentives for female labour force participation, while at the same time parents are subject to significant fixed costs of work. Hence, there is scope to make the support system more employment friendly.

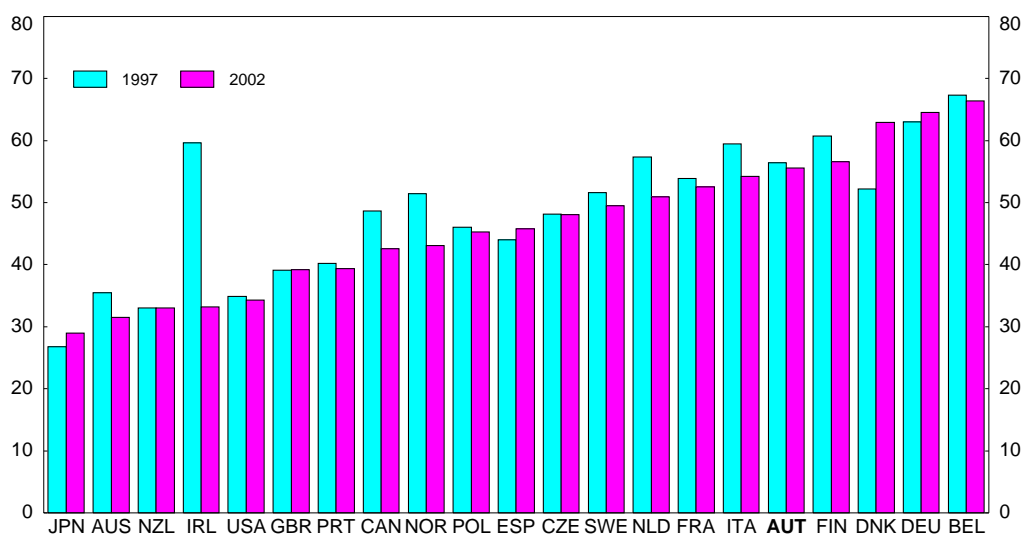
***Barriers to labour force participation interact with disincentives for labour demand***

When barriers to labour force participation are abolished, unemployment could rise during the transition to a new state of the economy with both higher labour force participation and higher employment, if the adjustment on the labour demand side is too slow. Hence, a number of specific issues need to be addressed to ensure that labour demand meets supply. The same is true in view of future challenges requiring a higher responsiveness of labour markets to structural change. In Austria, barriers to

labour force participation interact with a number of regulatory features that tend to increase the cost of labour to firms. With dismissal protection provisions being stricter for older workers, as age is a criterion to be taken into consideration in dismissal decisions, and severance pay being higher, laying-off older employees has turned out to be difficult in the past. For large groups of workers, wages increase strongly with seniority. With various regulatory provisions effectively insulating wage determination from outside wage pressure, this can make it worthwhile for employers to reduce employment of older workers. Utilisation of effective early retirement schemes thus becomes attractive for employers.

The tax burden on labour is high in Austria, with marginal tax wedges between compensation paid by employers and the employees' take home pay net of income taxes and contributions standing in the upper range within the OECD. Despite these high levels, marginal labour taxation has decreased only slightly since the second half of the 1990s (Figure 9). Rising social security contribution rates have played a key role in holding labour taxation at high levels. Hence, improving control over social security spending and encouraging labour force participation appear crucial to reducing effective labour taxation. Empirical evidence suggests that the size of the tax wedge on labour acts as a barrier to higher employment.<sup>9</sup> Indeed, the reduction of labour taxation in several EU member countries in the late 1990s may have been a significant factor behind the relatively strong employment growth observed within the EU, especially were the measures were targeted at low paid jobs.

**Figure 9. Marginal tax wedge on labour (1)**  
% of labour costs



1. For a single individual at the income level of the average production worker. Tax wedges are calculated by expressing the sum of personal income tax, employee plus employer social security contributions together with any payroll taxes as a percentage of labour cost. The effect of indirect taxes is not taken into account.

Source: OECD Taxing wages.

Aggregate real wage flexibility in Austria is high by international comparison. This has helped the economy to accommodate fluctuations in the business cycle while avoiding large fluctuations in unemployment. However, both the adaptability of the economy to structural change and productivity shocks and the employability of certain groups of employees, such as older people, require that relative wages adjust to asymmetric forces. A number of factors indicate that the flexibility of relative wages in Austria needs to be improved to increase the adaptability of the labour market to new demands.

In a range of areas Austria has taken significant steps within the last years to improve framework conditions in the labour market in favour of higher labour utilisation. The reform of the Public Employment Service stands as an example.<sup>10</sup> Scope for further improvements remains, and selected issues are highlighted further below in Chapter III.

### ***Productivity growth could be higher***

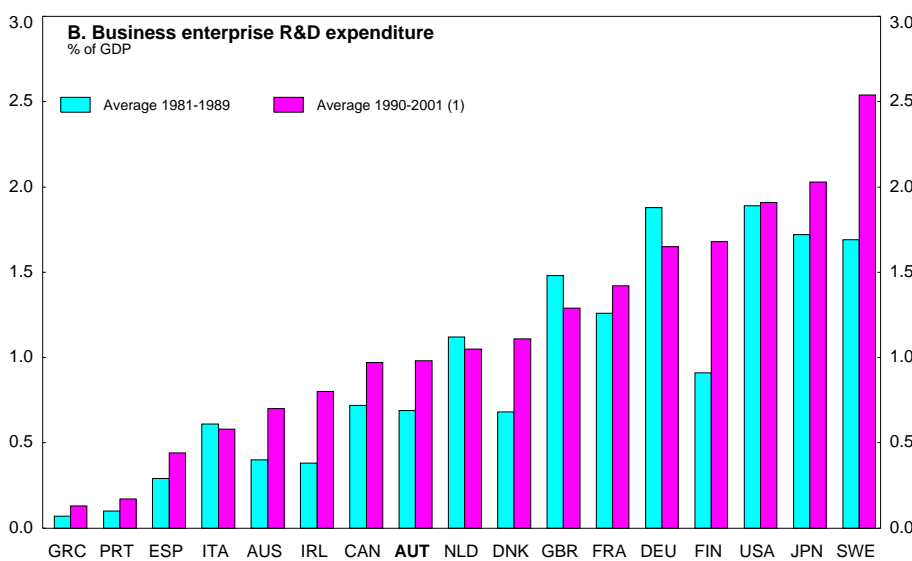
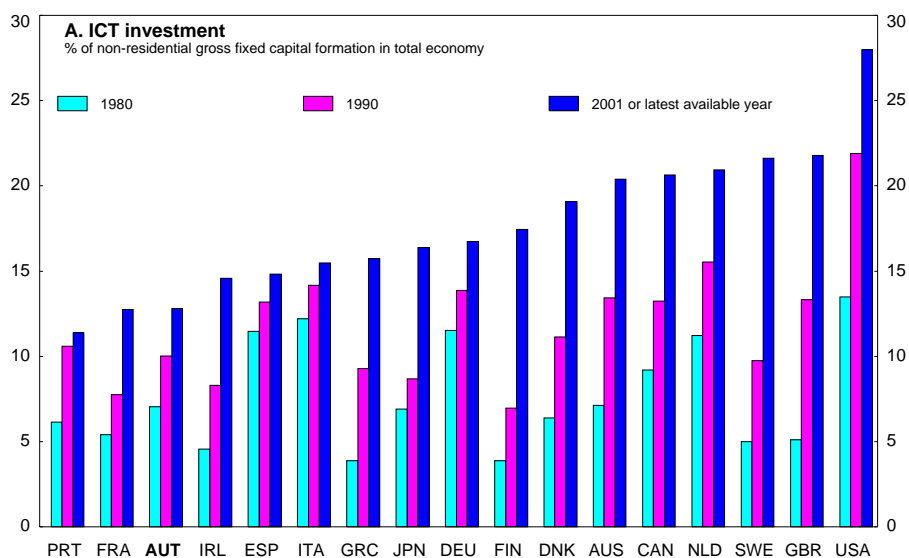
Growth performance would also be supported by stepping up productivity. Although Austria's fixed investment as a share of GDP is high by international comparison, this is not sufficient to produce high labour productivity growth. Other factors come into play. In particular the extent to which technological progress is readily applied in the production process and embodied in the capital stock is also important. The share of ICT investment is of interest in this respect as capital deepening from ICT investment has turned out to be of special importance for growth.<sup>11</sup> More generally, a high degree of competition in product, labour and capital markets is instrumental for innovation and productivity growth.

The favourable growth record in comparison to other OECD countries was primarily due to sizeable increases in labour and multifactor productivity. This, in turn, reflects high productivity gains mainly in manufacturing and construction, while, in contrast, performance was comparatively weak in some services industries, including distribution, transport and communications (see Table 1 above). Moreover, labour productivity growth appears to have slowed in the 1990s. Further strengthening of product market competition will be helpful, and possibly necessary, for keeping productivity growth in the high end.

Over the last two decades Austria has experienced a significant increase in the share of ICT related investment in total investment, as is the case with other OECD countries. However, the content of ICT in total investment remains low by international comparison (Figure 10, panel A). In the same vein, the share of research and development expenditure, both private and government, in GDP is relatively low (Figure 10, panel B).<sup>12</sup> Firms' access to equity capital is likely to play an important role in the development of new, innovative products or processes, which by nature tend to be risky activities. While the volume of venture capital funds has increased remarkably more recently, within the OECD, Austria appears at the lower end with respect to venture capital investment in terms of GDP (Figure 11). Given the prevalence of a bank-based financial market system, the limited role of large pension funds as providers of equity capital is likely to be an important determinant of this result.

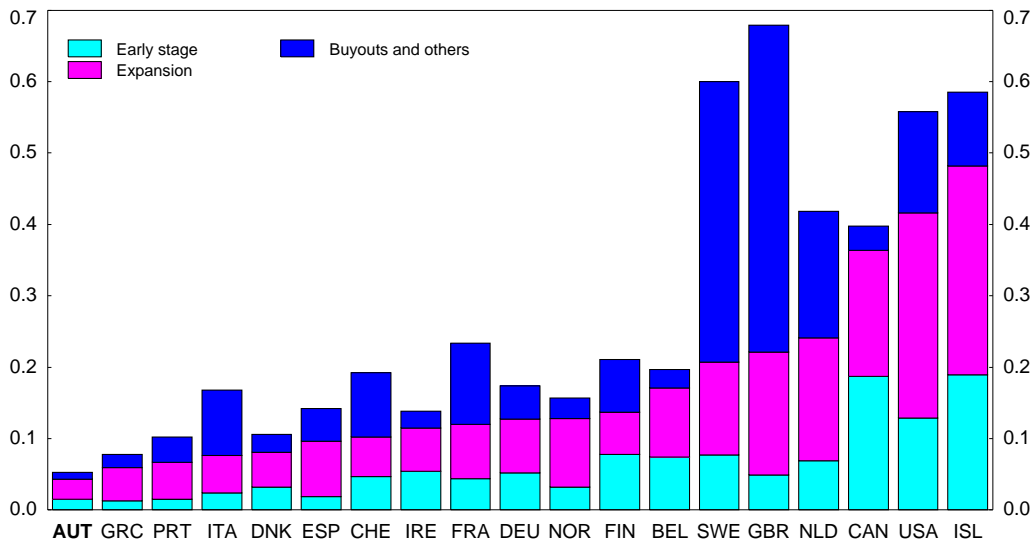
Other factors are likely to be important as well. Changes in work practices and organizational structures that are often needed to exploit new technologies increasingly require life-long learning so as to support the mobility of a well trained work force. More generally, training designed to increase the productivity of the workforce acts positively on labour demand and contributes to reducing the qualification mismatch between labour demanded and supplied. While Austria's apprenticeship system is well known for providing high quality vocational training, outcome and spending indicators suggest that there is considerable scope to raise the performance of the secondary and tertiary education system<sup>13</sup>. Also, the relatively low enrolment rate for adults aged 35 years and above indicates that adult learning still needs to adjust to new demands (Figure 12). Private and social investment in adult training can only pay off if subsequent employment spells are expected to be sufficiently long. This reinforces the need for complementary measures improving the framework conditions for higher labour force participation and labour demand.

Figure 10. ICT investment and R&D spending



1. 2001 where data are available; Austria 1998. Refer to OECD Main Science and Technology Indicators for methodological issues.  
Source: OECD - Capital Services Database; Main Science and Technology Indicators.

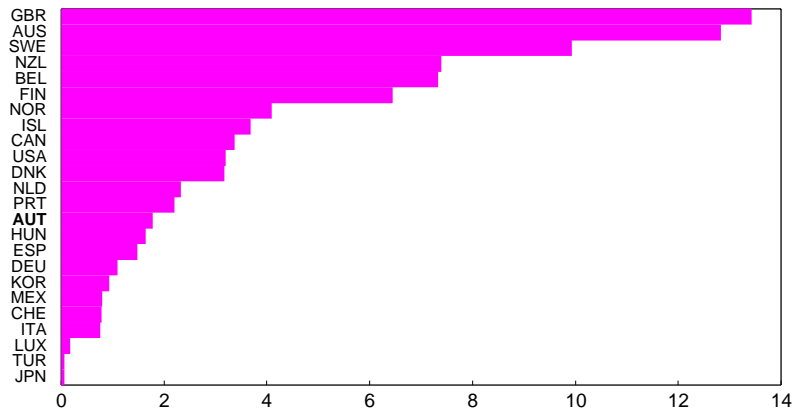
**Figure 11. Venture capital investment by stages, 1998-2001 (1)**  
% of GDP



1. The definition of private equity/venture capital varies across countries. Countries are ranked according to the sum of early stage and expansion. Source: OECD Venture Capital Database; Baygan, G. and M. Freudenberg 'The internationalisation of venture capital activity in OECD countries: implications for measurement and policy' OECD STI Working Papers No. 2000/7.

**Figure 12. Adults in formal education, 2001 (1)**

% of total enrolment of persons aged at least 35



1. Enrolments are full-time and part-time. Source: OECD Education Database.

1. Austria's export share to Germany increased from 37 per cent in 1988 to 39 per cent in 1993.

- 
2. The countries under consideration are Denmark, Belgium, the Netherlands, Sweden and Ireland, the same as those considered in Figure 3 above.
  3. See OECD (1998*a*, 2001*a*).
  4. A decomposition of the evolution of labour force participation rates by the Secretariat shows that between 1990 and 2000 the change in the age distribution reduced the Austrian participation rate by some 0.8 per cent.
  5. Between 1990 and 2002 the registered unemployment rate for persons aged 55 and older increased from 7.1 per cent to 11.2 per cent for males and from 6.0 per cent to 11.5 per cent for females. Over the same period the total unemployment rate rose from 5.4 per cent to 6.9 per cent (definition excluding self employed).
  6. According to the statistics of the Austrian Social Security Association the entry age into old age retirement stood at 62.2 and 59.4 years for males and females, respectively. .
  7. The average effective age of retirement is based on labour force survey data and derived from the observed decline in participation rates over a 5-year period for successive cohorts of workers aged 40 and over.
  8. In the employment statistics, people who do not work in the second phase of an *Altersteilzeit* spell are counted as employed.
  9. See Nickell, S. and S. Nunziata (2000).
  10. See OECD (2001*a*).
  11. OECD (2003*b*).
  12. Gross spending on research and development in Austria has increased continuously from the beginning of the 1980s. The Austrian government is targeting to increase gross R&D spending to 2.5 per cent of GDP by 2006, and endorses the EU target of 3 per cent by 2010. On the issues involved, see Sheehan, Jerry and Andrew Wyckhoff (2003),. Pilat *et al.* (2002) and. Aiginger, Karl (2003).
  13. With respect to tertiary education see OECD (2001*a*).