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OVERVIEW



Summary

The Austrian economy has weathered the crisis well on the back of an export-led recovery. The authorities should seize the opportunity to strengthen reforms and maintain high growth, which in the past has been considerably boosted by European integration effects which are likely to fade out in the future. In this context recommendations from earlier *OECD Economic Surveys* remain relevant:

- All subsidised avenues into early retirement should be eliminated.
- The work incentives of low-skilled workers should be strengthened and their cost of employment reduced. Successful up-skilling programmes should be further developed.
- Early child care infrastructure and full-day schooling should be expanded, with recent government initiatives going in the right direction.
- Education reforms should continue, to overcome the excessively early streaming of students, and to permit universities to select students and charge tuition fees, accompanied by a comprehensive grant and income-contingent loan system to avoid socioeconomic segregation.
- Competition should be further enhanced in network services such as rail, postal services and electricity, as well as in liberal professions.

Fiscal vulnerabilities, while low in international comparison, have increased through the crisis. The recent consolidation measures may not suffice to prepare for future risks and challenges, not least related to ageing. In these circumstances, Austria should make full use of the performance budgeting framework that it plans to introduce from 2013, for more assertive spending prioritisation and cost-benefit checks. Despite some recent improvements, the tax structure also remains biased against employment and growth and offers room for reform. Key fiscal policy priorities should be:

- Accelerating fiscal consolidation to bring the debt to GDP ratio below 60%.
- Taking more frontloaded action to meet foreseeable medium-to-long-term spending pressures.
- Reforming the *Domestic Stability Pact* and the *Fiscal Equalisation Act* and implementing the fiscal framework reforms at all levels of government.
- Seeking efficiency gains in all major spending areas.
- Switching the tax burden away from labour and entrepreneurship toward less distortive taxes.

The highly regarded Austrian health system is expensive. The governance and funding structure of the system is excessively fragmented, makes too much use of inpatient care in hospitals, and entry and competition are *de facto* limited in most health markets. Lifestyle factors are generally not supportive of good health outcomes and put additional pressure on costs. The authorities have introduced several reform initiatives in recent years. These should be continued and intensified in the following areas:

- More clearly assign performance, financing and spending responsibilities.
- Fully enforce the national capacity plan for inpatient and outpatient care.
- Introduce performance-based payment mechanisms in both inpatient and outpatient care and increase competition in the pharmaceutical market.

- Promote disease management programmes in all chronic care areas.
- Set out challenges of the medium-term fiscal outlook of the system, through detailed health and long-term care spending projections and scenarios.

Assessment and recommendations

The Austrian economy continues to impress with very good economic performance while maintaining a high degree of social cohesion. This strength rests on three pillars:

- A successful export-oriented economy with entrepreneurs, who understood how to reap the benefits from past decades of European integration for workers, asset holders and the treasury alike.
- A highly skilled and motivated labour force, underpinning generally good labour market performance measured by low unemployment overall and especially low youth unemployment.
- Social partners, taking responsibility for preparing reform proposals for the government and going beyond the traditional role of negotiating wages and work conditions as well as organising social security services.

Austria, like other export-oriented economies, was hit hard by the crisis, revealing particular vulnerability. Positive external shocks in the wake of European integration measures will most likely not continue with the same strength as in the past two decades and drivers of growth will depend more on domestic sources. The currently strong recovery offers a golden opportunity to strengthen reform efforts and consider recommendations from earlier *Economic Surveys*, notwithstanding recent progress, in particular in the following areas:

- While Austria has many employment opportunities for skilled workers in core age groups and an excellent school-to-work system keeps youth unemployment low, there are problems with: *i)* unskilled workers, who face high marginal tax rates; *ii)* older workers, who face a high tax on continuing to work; and *iii)* women at lower income levels, for whom the tax and benefit system interact in a way which makes reconciling work and family responsibilities costly. The government has recently introduced a range of measures in support of better reconciling work and family obligations, the impacts of which should be closely monitored.
- The expansion of Austrian financial institutions into newly emerging market economies after the fall of the *Iron Curtain* is generally seen as a success story. Nevertheless the crisis demonstrated that governments may be implicated in excessive risk taking at non-negligible costs for current and future tax payers. The coming strengthening of capital requirements should be taken as an opportunity to open a discussion with the financial sector as to how the government could be more insulated from future rescue operations.
- Growth and social cohesion will depend more on own policy initiatives to increase potential growth and on reducing the strong tendency to inherit education outcomes over generations.

The structural chapters in this *Economic Survey* address public sector reforms in two areas:

- Fiscal consolidation and institutions: While Austria has made great efforts to improve its fiscal framework at the federal government level, work remains to be done: *i)* avoid pro-cyclical fiscal outcomes, in particular at lower levels of government and in

the social security system, *ii*) better target social transfers; and *iii*) improve the tax structure in order to make taxes less of a burden for economic activity.

- Health care reform: This is occupying stakeholders at all levels of government, encompassing the rich structure of fiscal federal relations in Austria as well as the social partners, both in their role as self-organising the social security sector, as well as drivers of reform in general. The Austrian population has a high regard for its health care system, although in international comparison it comes across as expensive, fragmented and lacking agreed targets.

The recovery provides an opportunity to reinvigorate reform efforts

The Austrian economy started to recover in the second half of 2009 on the back of strengthening external demand and has surpassed its pre-crisis peak in the first quarter of 2011. Investment in the metals and machinery sector expanded strongly in the second half of 2010, more than offsetting further declines in construction investment. Consumption has expanded steadily, though at a subdued rate. The labour market recovered quickly from the crisis with employment growing robustly and the unemployment rate falling to 4.2% in late 2010, compared with a crisis peak of 5.1%. Wage growth remained subdued, supporting Austria's competitiveness. Harmonised consumer price inflation increased sharply in early 2011, reaching 3% (year-on-year) in the first quarter, mainly due to energy and food prices as well as minor excise tax hikes on tobacco and mineral oil products. Core inflation, however, also rose somewhat to 1.8% in the first quarter.

The outlook is favourable and fiscal consolidation has begun

Looking ahead, growth in Austria is set to grow above its potential rate in 2011 and 2012 and continue to benefit from robust external demand through its strong trade linkages with Germany (Table 1). The authorities do not expect the opening of the labour market to workers from the new EU member countries on 1 May 2011 to result in disruptive labour inflows, but it could ease skill shortages and also keep wage pressures in check in the near future. In this context, the government's decision to promote skilled labour migration from non-EEA countries through the introduction of a "points based" immigration system (*Rot-Weiss-Rot Karte*) from July 2011 onwards should be welcomed. As labour productivity increases further, competitiveness and thus exports should remain strong. Real interest rates are expected to remain low in 2011, which will support investment. Employment growth is expected to be robust in 2011 holding the unemployment rate below the structural level of 4¼ per cent. However, high consumer price inflation will weigh on real disposable income and private consumption growth in 2011. Inflation is expected to decline in 2012, supporting a moderate pick-up in consumption.

Table 1. Austria: demand, output and prices

	2007	2008	2009	2010	2011	2012
	Current prices € billion	Percentage changes, volume (2005 prices)				
GDP at market prices	272.1	2.0	-3.4	2.1	2.9	2.1
Private consumption	143.7	0.6	1.2	1.0	0.9	1.2
Government consumption	49.1	4.0	0.4	-0.5	-0.2	0.5
Gross fixed capital formation	58.3	2.8	-7.8	-0.9	3.3	2.5
Final domestic demand	251.1	1.8	-1.1	0.3	1.2	1.4
Stockbuilding ¹	4.7	-0.6	-1.0	0.6	1.0	0.0
Total domestic demand	255.8	1.1	-1.5	1.0	2.1	1.3
Exports of goods and services	161.4	0.5	-15.6	10.3	9.1	6.8
Imports of goods and services	145.1	-1.7	-12.6	8.2	7.8	6.0
Net exports ¹	16.3	1.2	-2.6	1.4	1.1	0.8
<i>Memorandum items</i>						
GDP without working day adjustments	272.5	2.2	-3.9	2.1	2.9	2.1
GDP deflator	-	1.7	0.7	1.6	1.9	1.6
Harmonised index of consumer prices	-	3.2	0.4	1.7	3.1	1.8
Private consumption deflator	-	2.5	-0.7	1.5	2.5	1.9
Unemployment rate ²	-	3.8	4.8	4.4	4.2	4.0
Household saving ratio ³	-	11.8	11.1	9.1	9.0	8.9
General government financial balance ⁴	-	-1.0	-4.1	-4.6	-3.7	-3.2
Current account balance ⁴	-	4.6	2.9	2.5	3.2	3.9

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook Sources and Methods* (www.oecd.org/eco/sources-and-methods).

- Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
- Based on *Labour Force Survey* data.
- As a percentage of disposable income.
- As a percentage of GDP.

Source: OECD database.

Fiscal vulnerabilities, while low in international comparison, have increased in the wake of the crisis. Persistent budget deficits since 1974, even during times of above-potential growth, together with crisis-related measures to support the Austrian financial sector and European rescue operations have raised gross debt to 72% of GDP. The true fiscal situation became more apparent with re-integration into the government accounts of deficit spending and debt from previous off-budget operations (the railway company and hospitals). In 2011 the federal government implemented a consolidation package to gradually reduce the deficit from its peak of 4.6% in 2010 to below 3% of GDP by 2013. The bulk of consolidation efforts falls on spending restraint by the central government (mainly social expenditure cuts).

The labour market has weathered the crisis comparatively well

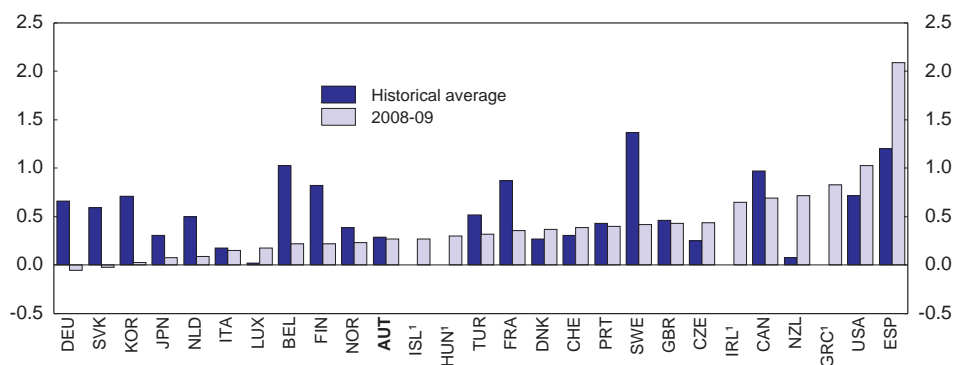
The unemployment rate increased significantly in Austria during the crisis, by about 1.5 percentage points from trough to peak, more than in Germany but less so than the 3 percentage points in the OECD on average. Given the large drop in output in Austria, which at 3.9% was close to the OECD average of 3.5%, the unemployment reaction was modest, although broadly in line with the historical relationship between GDP and unemployment (Figure 1 and Box A1.2). Total employment fell by about 1% with

employment in manufacturing and construction affected most. In line with previous recessions in Austria, the main adjustment to the reduction in demand took place via a reduction in average hours per worker, which accounted for about ¾ of the reduction in total hours worked. This may have reflected skill shortages, as suggested by survey measures, and high overtime hours which facilitated the reduction in hours (Stiglbauer, 2010). However, active labour market policies are likely to have played a role as well (see below).

Since the end of 2009 the Austrian labour market has recovered relatively quickly. The unemployment rate dropped about 1 percentage point to 4.2% in the last quarter of 2010 compared with a reduction of 0.3 percentage points in the OECD as a whole and still rising unemployment rates in the euro area. Total employment now stands above pre-crisis levels in Austria, although a surge in temporary agency workers accounts for a significant part of the rebound and manufacturing employment is still below pre-crisis levels. The share of long-term unemployed and the labour force participation rate remained broadly constant through the downturn, suggesting that hysteresis effects are less of a concern in Austria than in several other OECD countries.

Figure 1. Change in unemployment in the 2008-09 recession in historical comparison

Okun coefficient (peak-to-trough ratio of the increase in the unemployment rate to the decrease in GDP)



1. Historical average not available.

Source: OECD (2010), *Employment Outlook 2010: Moving Beyond the Job Crisis*.

Active labour market policies helped keep people in work

The short-time work (STW) scheme, whereby governments subsidise a temporary decrease in working time, helped prevent layoffs, and two labour market packages enacted in 2009 included measures to increase its attractiveness. However, the recourse to this scheme was quite limited. Participation peaked in April 2009 at 38 000 enrollees, decreased rapidly since, and is currently at negligible levels. About 26 000 employees or less than 1% of total employment were subsidized on average in 2009, compared with more than 3% and 5% in Germany and Belgium, respectively (OECD, 2010a). With an average reduction in working time by about 26% (BMAK, 2010), the contribution of the STW schemes to the total hours reduction of about 3.6% was about ¼ percentage points. Estimates of counterfactual employment developments without the STW suggest that about 4 000 permanent jobs or 0.12% of total employment, may have been protected by this scheme in Austria compared to about 0.7% and 1.3% of total employment in Germany and Belgium, respectively (Hijzen and Venn, 2011). Some firms have sought alternative measures, such as temporary lay-offs. Indeed, the number of registered unemployed in 2008 and 2009 with confirmation of future employment rose (Bock-Schappelwein *et al.*, 2011).

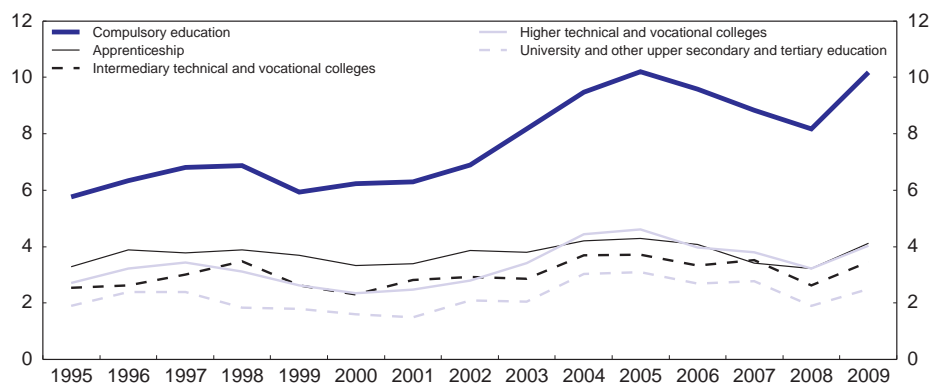
Eligibility was eased or financial support increased for several other active labour market programmes. In particular recourse to subsidized study leave (*Bildungskarenz*) increased significantly during the crisis, from about 1 500 participants on average in 2008 to a peak of 7 500 in February 2010. Participation in up-skilling and re-qualification programmes subsidised by the Public Employment Service (PES) also increased substantially. Finally, the government eased access to the old-age part-time scheme, by which older employees can reduce working hours before retirement without reductions in their pension benefits, and the requirement for firms to hire a new employee for every worker put on part-time was suspended on 1 September 2009. About 4 400 people were granted such eased access in the first year (BMASK, 2010). While this scheme may have helped to prevent lay-offs during the crisis, it runs against necessary efforts to increase the employment potential of older workers, as discussed below.

Better integrating low-skilled, older and female workers into the labour market is a major challenge

As described in the *2009 OECD Economic Survey of Austria*, the Austrian labour market is characterised by a well-performing core of skilled prime-age workers, but also a number of more vulnerable groups, particularly unskilled, older and female workers with family responsibilities, whose labour market experience is less enviable. Unemployment rates of low-skilled workers are high and have been deteriorating in the past (Figure 2). This problem is generating a growing concern in Austria and the crisis was a reminder of the particular vulnerability of this group in economic downturns. Employment of this group can in general be improved through up-skilling and re-qualification measures and by lowering their costs to employers. Austria already spends a substantial share of total expenditures for active labour market programmes on training measures (55% compared with 25% in the average OECD country as of 2008). *To reduce the costs to employers, cuts in employer social security contributions for low-skilled workers should be considered. In this context, the “wage top-up” (Kombilohn), introduced in 2006 and reformed in 2009, could be extended to further well-defined groups of low-skilled workers.*

Figure 2. Low-skilled workers fare poorly in the labour market

Unemployment rate by highest completed education, %

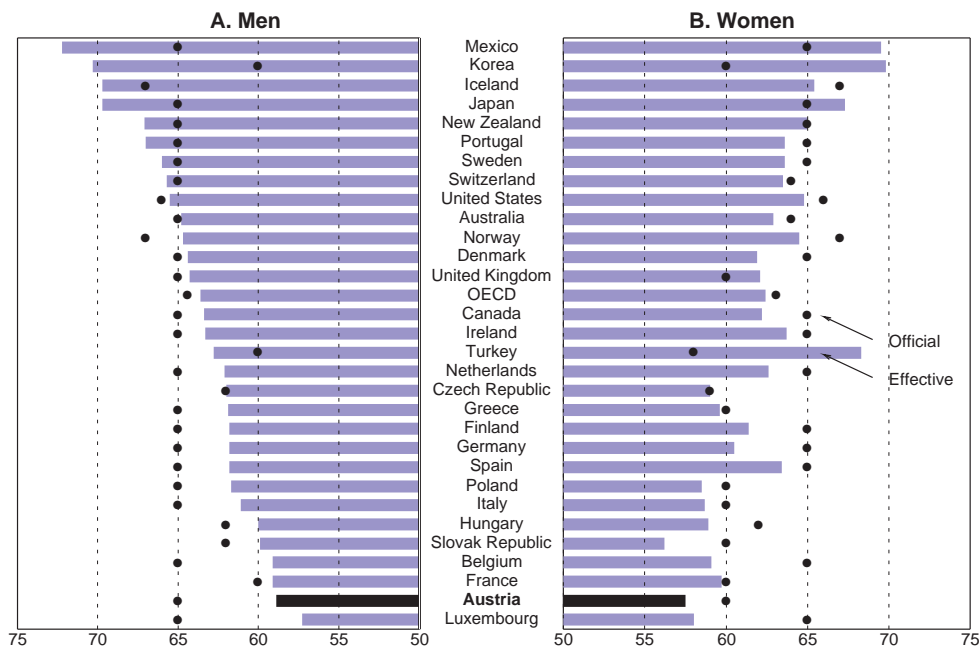


Source: Statistics Austria.

Despite recent improvements, labour force participation rates for older workers (aged 55-64) remain low and the average effective age of labour-market exit for men is 58.9 years, the second lowest among all OECD countries (OECD, 2011a) (Figure 3). The high number of people exiting the labour market through disability pensions as well as still existing early retirement programmes are the major reasons. *The introduction in 2011 of the right for rehabilitation in addition to compulsory rehabilitation before eligibility for a disability pension and initiatives to improve work-place quality are steps in the right*

direction. They should be complemented with a further strengthening of eligibility criteria, including an obligation to look for jobs in alternative occupations. Other important early retirement schemes are available in Austria. Under the early retirement scheme for long-term contributors to the public pension system (*Hacklerregelung*) employees who have paid contributions for 40 (women) or 45 (men) years can retire at 55 (women) or 60 (men) without any reductions in pension benefits. The provision that time spent in non-compulsory education can be substituted for regular years of contributions by paying a lump-sum per month is particularly problematic, as it increases the incentive for high-skilled individuals to leave the labour market, even though this lump-sum was increased significantly on 1 January 2011. The decision to tighten this scheme by 2014 - the authorities expect they can halve the current yearly inflow - is welcome and should not be postponed again. *Merging the scheme into an actuarially neutral pension scheme, which neither subsidises nor penalises retirement at different ages, would be preferable.*

Figure 3. The average effective retirement age is too low



Note: The effective retirement age shown is for the five-year period 2004-09; the pensionable age is shown for 2010.

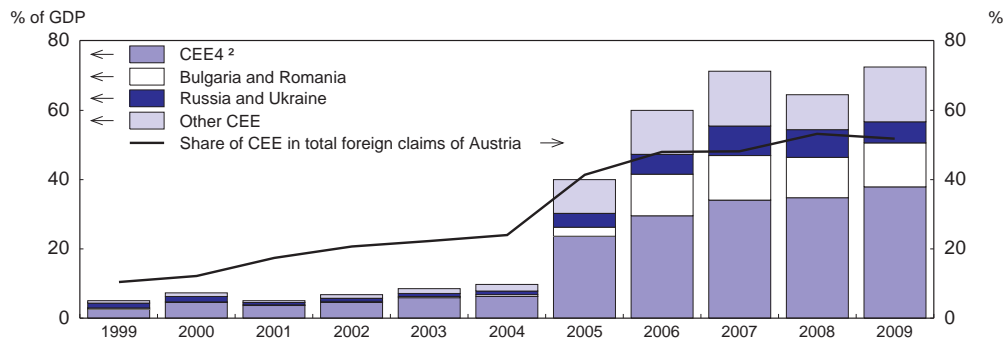
Source: OECD, *Pensions at a Glance 2011: Retirement-Income Systems In OECD and G20 Countries*, Figure 2.3, p. 43.

Family support in Austria is biased in favour of cash benefits thus making it expensive to reconcile work and family obligations, both in terms of benefits lost and cash and organisational expenses for childcare. Women are relatively more often working part time and finding it less attractive to work when there are small children to look after. Therefore, an income-based child care allowance (*Kinderbetreuungsgeld*) was introduced in January 2010, which is in principle meant to partially substitute the income of parents who wish to withdraw from the working life for a shorter period only, and would normally earn a higher income. As outlined in earlier *Economic Surveys*, efforts to rebalance family support should continue through expanding early child care and education infrastructure and the availability of full-day schooling. Therefore, the coalition partners decided at the end of May 2011 to continue the expansion of childcare facilities, especially for children aged up to three years.

The financial sector is recovering

As highlighted in the *2009 OECD Economic Survey of Austria*, the rapid and successful expansion of Austrian financial services into the newly emerging economies of Central and Eastern Europe (CEE) and South-East Europe (SEE) poses significant regulatory challenges. The global financial crisis severely affected the international portfolio of the Austrian banking sector. The impact was mainly coming through the high exposure to economies in CEE and SEE with some of them experiencing a severe downturn following a period of excessive credit growth (Figure 4). Further risks were revealed through the high level of lending in foreign currencies, including to Austrian clients, and to a lesser degree, the participation in high-risk international investments in other regions.

Figure 4. Build-up of Austrian banking assets in CEE¹



1. CEE includes: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Former Yugoslav Republic of Macedonia, Moldova, Republic of Montenegro, Poland, Romania, Russia, Republic of Serbia, the Slovak Republic, Slovenia, Turkey and Ukraine. The country coverage slightly differs between trade, FDI and banking statistics.
2. CEE4 includes: the Czech Republic, Hungary, Poland and the Slovak Republic.

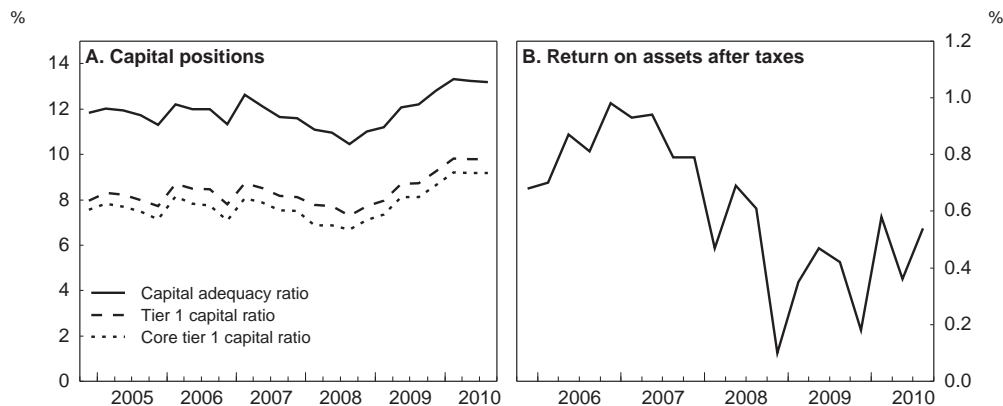
Source: Bank for International Settlements and *OECD Economic Outlook database*.

Substantial public intervention was needed to support the banking sector in the wake of the global crisis. The Austrian authorities introduced in 2008 a top-up of the deposit guarantee scheme of EUR 10 billion, EUR 15 billion for capital injections in financial institutions, and EUR 75 billion for supporting interbank lending and for government guarantees of bank bond issuance. Some of these funds were later reallocated to guarantees to non-financial corporations and euro support measures. Nevertheless, EUR 15.9 billion of federal guarantees for debt instruments, and EUR 7.5 billion for capital injections and asset guarantees are still in place. Two banks, including one of the six largest banks, had to be nationalised. *While the support should stay in place as long as needed, clear exit strategies would lift uncertainty and enhance market confidence.*

In light of the high fiscal costs of the crisis, efforts have been stepped up aiming at a better and higher capitalisation of financial institutions, especially the systemically important ones. The capitalisation of Austrian banks is improving, particularly among the largest banks that used to be the most leveraged prior to the crisis (Figure 5). In contrast to the situation in early 2009, recent rounds of stress tests show that even deep negative shocks would not threaten solvency. There is also no sign of credit rationing in the domestic economy. However, despite reaching a consolidated core capital adequacy ratio of 9.8% (OeNB, 2010), Austrian banks continue to have a below-average capital adequacy. Basel III capital requirements will require raising the quality of the capital base and building additional buffers. The total size of newly required capital due to Basel III and the repayment of government support is estimated at between EUR 15 and 18 billion considering a period until 2020, which might lead to a cumulative decline in GDP growth by 0.23 percentage points over three years (Kopp *et al*, 2010), in line with estimates for the euro

area (Slovik and Cournède, 2011). Raising new capital might be difficult, however, given the importance of the multi-tier decentralised sector in Austrian banking. Weak local equity market performance may also pose a problem, given an increased risk-aversion among international investors, the introduction of the bank tax and a strong competition for equity capital among European banks. *It would be advisable to require all major banking groups to present a clear medium-term strategy of capital strengthening, including a gradual repayment of government capital.*

Figure 5. Profitability and capital adequacy of Austrian banks¹



1. Consolidated data.

Source: OeNB.

The recent rebound in profitability is primarily driven by the recovery of CEE economies. The major Austrian banks continue to see sustainable and profitable growth opportunities in the CEE region and remain committed to lending there in the medium and long term. However, the profitability of Austrian banks remains well below its pre-crisis level. Moreover, not all losses, particularly on foreign exchange lending, seem to have been recognised by foreign subsidiaries and loan-loss provisions are expected to increase further (Pann *et al.*, 2010). Financial stability plans should therefore be ready in the event that the situation worsens substantially in one or more CEE countries.

As was revealed by the crisis, the cross-border supervisory architecture in Europe prior to the crisis was prone to supervisory failures, high compliance burden and insufficient attention to stability at the group level (De Larosière Group, 2009). These problems are now being addressed in Austria and internationally (Box A1.1). The Vienna Initiative/European Bank Coordination Initiative (a round table platform including all major banks, national authorities, the European Commission and international financial organisations active on a particular market) provided and continues to provide an important platform for crisis management. Furthermore, the introduction of the European Systemic Risk Board and the European Banking Authority is expected to bring sustained gains in terms of early warning systems, regulatory harmonisation through a single European rule book, strengthening of supervisory colleges and improved co-operation in crisis prevention and management within the EU. *The Austrian supervisory authorities should cooperate very closely with these newly established authorities. An attempt should also be made, directly by the Austrian supervisors, and indirectly by Austrian authorities in the context of the EU accession and EU neighbourhood policy dialogues, to expand the use of these new supervisory tools in co-operation with supervisors in non-EU countries, where Austrian banks are active.*

Medium-term growth will depend crucially on domestic structural policy reform...

Despite the broadening recovery, Austria faces several challenges over the medium term and potential growth is unlikely to return to pre-crisis levels unless structural reforms are pushed forward. First, fiscal policy is moving towards consolidation, damping demand and even stronger consolidation efforts than currently planned might be necessary in the future (see Chapter 1). Second, the growth impetus from European integration is likely to weaken over the coming years. Over the previous decade, strong export growth to the CEE region and robust productivity growth in the export sector stemming from company restructuring in the wake of EU accession boosted economic growth (Breuss, 2010). Finally, ageing will also negatively affect potential growth. Under current projections from the Statistical Office, the working age population will grow more slowly after 2011 and contract after 2020.

To counteract these growth-moderating forces further structural reforms are required and recent government plans go in the right direction. Besides further potential for reforms to increase labour utilisation as discussed above, the recent OECD growth benchmarking exercise (OECD, 2011b) points towards necessary improvements in labour productivity. Simulations for comparable other countries show that the gains from product market reform can be considerable (Arnold and Wörgötter, 2011). Two areas deserve special attention. First, while the manufacturing sector is characterised by strong productivity and output performance, the service sector is lagging behind. Product market reforms to strengthen competition in the service sector are therefore warranted. Second, further reforms of the educational system are required. In particular the graduation rates from academic tertiary education remain low in international comparisons and lifting these rates might be necessary to complement and fully reap the benefits of reforms already undertaken to strengthen the innovative capacity (OECD, 2009; 2007). In this context, while difficult to calculate, a recent study (Ederer *et al.*, 2011) estimates that Austria could lift its real GDP growth potential by about 0.3 percentage points on average between 2010 and 2020 if all R&D, education and employment targets set out in the EU *Lisbon Strategy* and the follow-up strategy called *Europe 2020 - A European strategy for smart, sustainable and inclusive growth* were reached.

...in particular in the service sector...

There is ample room for improvement in network industries, where high network access prices and widespread state ownership deter market entry and thus competition and innovation. Austria has continued to implement EU directives relating to the network industries. *However, further progress should be made in monitoring market behaviour, tackling distortive behaviour of incumbents and improving the corporate governance of state-owned enterprises. Further stimulating de facto competition in these sectors, in particular in the rail and postal services, is a matter of urgency. Continuing privatisation efforts, notably in the electricity sector, would also be welcome.*

Restrictive regulations remain widespread in the professional services sector. In particular, self-imposed regulations and licensing requirements and compulsory membership in professional associations hinder competition and productivity growth. *These regulations should be further curbed and compulsory membership in professional associations for liberal services abolished, while maintaining high quality standards and consumer protection. Regulations preventing the establishment of interdisciplinary firms between liberal professions and other businesses - e.g. between lawyers, tax advisers and management consultants - should also be reduced.* More generally, an evaluation of Austrian competition law is currently being carried out and a reform proposal was recently finalised by the social partners.

...and in the education system

While the Austrian educational system provides good vocational skills, technological change and international competitive pressures require new and more generic skills. Specific and well-recognised weaknesses of the Austrian educational system are: *i) the average academic performance of students and especially the underperformance of*

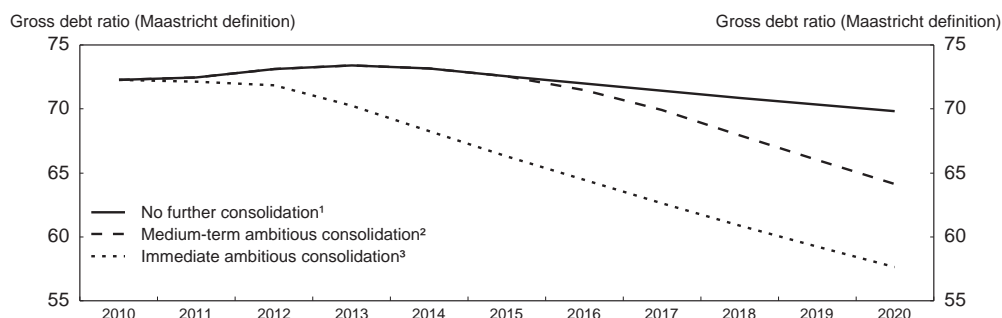
immigrants; *ii*) the strong dependence of educational performance and choices on socioeconomic backgrounds and the early streaming into different educational routes; and *iii*) the low tertiary enrolment rates. The previous *Economic Survey* identified the following areas for improvement: *i*) *increasing the participation in pre-school education, with a particular focus on children from weak socioeconomic and immigration backgrounds;* *ii*) *overcoming the excessively early streaming of students in compulsory education;* *iii*) *rationalising the present school infrastructure and re-investing freed resources into improving teachers quality;* and *iv*) *greater university autonomy in selecting students and charging tuition fees accompanied by a comprehensive grant and income-contingent loan system to avoid socioeconomic segregation.* Significant policy initiatives are being undertaken but the need for deeper reform in several areas remains, as underlined by the disappointing results in the most recent PISA survey:

- In the area of pre-school education, free one year compulsory pre-school on a half-day basis was introduced in September 2010. Some *Länder* (regional governments) went further and introduced compulsory pre-school at an earlier age for children with deficits in speech and languages (e.g. *Vorarlberg*). Some progress has also been made to improve co-operation between federal, *Länder* and municipal governments with the adoption of a framework of education for pre-school institutions in 2009.
- To overcome the early streaming of students in compulsory schooling, the Austrian government had launched the “New Secondary School” (*Neue Mittelschule*), which unifies the “general” and “academic” lower secondary school for pupils aged 10 to 14, in a pilot project in 67 schools in the school year 2008-09. The number of participating schools has risen to 320 since then but participation of the “academic” lower secondary schools is still very low (only 11 of the 320 schools). An evaluation of the project is scheduled for 2012. A number of initiatives and projects have been launched to improve teacher quality.
- In tertiary education, additional funds have been invested and are planned for 2011 and 2012 to improve the teaching and research infrastructure. In March 2011 Austria adopted a comprehensive strategy for research, technology and innovation (*Strategie der Bundesregierung für Forschung, Technologie und Innovation*), which includes different measures to improve and clarify the financing of public universities. In addition several measures have been taken to improve the governance and transparency of tertiary educational institutions.

Public sector inefficiencies have become less affordable

Although Austria’s fiscal performance does not compare unfavourably against other EU or OECD countries, future expenditure pressures stemming from liabilities incurred by the public sector urge a quick reversal of the increase in the deficit and debt ratio. Public finances worsened markedly over the past two years, driven by discretionary stimulus, financial sector support measures, the operation of automatic stabilisers and a comprehensive revision of government data by Eurostat. Consolidation measures specified in the 2011 Budget are expected to bring the deficit back to below 3% of GDP by 2013 and then to 2% by 2015. OECD simulations suggest that this may not be sufficient to bring down debt rapidly enough (Figure 6). By contrast, an ambitious and front-loaded consolidation programme may reduce the debt-to-GDP ratio to 60% by 2020. A less front-loaded scenario, even if ambitious in the medium-term, would leave the debt-to-GDP ratio above 60% by 2020. *To bring the debt ratio back to a sufficiently declining path and forestall possible financing risks, the pace of fiscal consolidation should thus be stepped up.*

Figure 6. Alternative consolidation and debt dynamics scenarios



1. Nominal GDP growth of 4.7% in 2011 and 3.7% thereafter, and a budget deficit of 3.7% of GDP in 2011 with a gradual reduction to 2% of GDP by 2015 and no further consolidation thereafter is assumed.
2. Same assumptions as in (1) but further consolidation of 0.5% is assumed after 2015 until a budget deficit of 0.5% is reached.
3. Same nominal GDP growth assumptions as in (1) and (2) but the deficit is gradually reduced from 4.6% in 2010 to 0.5% of GDP by 2014 and held constant thereafter.

Source: OECD calculations based on data from *OECD Economic Outlook database*.

Long-term spending pressures do not play a big role in reform preparation

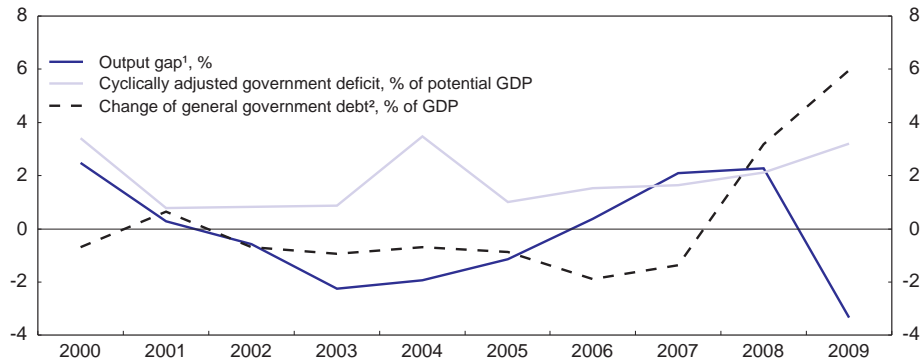
Medium- and long-term challenges are considerable and do not seem to have triggered much frontloaded policy action so far. The government expects that population ageing will add an extra 3.1% of GDP to public spending at the 2060 horizon. A recent OECD report (2011a), however, shows that the increase in pension costs due to demographics alone may be 9 percentage points higher than currently projected for that year, unless work careers are extended and pension benefits reduced significantly relative to earnings, which seems unlikely without further policy action (see above). Costs may also grow faster in other areas. Projections suggest that health care costs up to 2030 may be more than 4 percentage points higher than currently expected (see Chapter 2). Long-term care spending projections are also subject to upward risks, and the expected reprioritisation of spending programmes may lead to additional fiscal tensions. Another risk factor going forward is state guarantees to public enterprises, the banking sector, and other euro area countries, which have reached significant amounts. *There is a need for a more forward-looking fiscal agenda to prepare for future fiscal stress. Medium to long-term fiscal projections should be more instrumental in guiding front-loaded policy action - keeping in mind the long implementation and outcome lags of structural policies. Transparency with regard to off-budget entities and contingent liabilities of the public sector should be increased. In this regard, an evaluation of the medium- and long-term fiscal impact of putting government programmes into off-budget vehicles should be undertaken.*

Problems in controlling debt suggest the fiscal framework needs further strengthening

Austrian gross government debt remained high during good times and the opportunities provided in boom periods were missed (Figure 7). Existing fiscal rules such as the medium-term target of a balanced budget over the business cycle have not prevented the gross debt ratio from remaining on average 5 percentage points above the Maastricht 60% gross debt ceiling during the decade preceding the crisis. Off-budget operations which eventually show up on the government balance sheet have been one factor here. This history suggests the fiscal framework currently in place could usefully be strengthened. *The current fiscal rule should be augmented with a debt objective which implies steadily paying down debt beyond the 60% level. Past slippage from missing the target of budget balance over the cycle should be made visible on a notional account and lead to corrective measures*

in subsequent budget periods at all levels of government. In this context, specifying a target rate of growth of real general government spending would help.

Figure 7. Austrian government debt remained high



1. Output gap of the total economy.
2. General government gross financial liabilities according to Maastricht definition.

Source: OECD Economic Outlook database.

Further developing the budgetary framework at all levels of government is needed

The introduction of a four-year medium-term expenditure framework in 2009 marked an important improvement in budgetary planning. Expenditure slippages have been avoided and “December fever” successfully contained. However, the expenditure framework covers less than half of total government spending and has not fully eliminated pro-cyclical trends stemming from revenue windfalls. Austria is much better in containing expenditures in bad times than in good or better-than-expected periods (Brandner *et al.*, 2009). While the cyclical position (as measured by the change in the estimated output gap) improved by about 4% of GDP between 2003 and 2008, the underlying deficit deteriorated. This may be related to the design of inter-governmental fiscal relations, with sub-federal levels receiving their share of mostly cyclically-sensitive tax revenues without being required to contribute to consolidation. *A reform of inter-governmental fiscal relations would help contain expenditures. In particular, the Domestic Stability Pact (DSP) and the Fiscal Equalisation Act should be reformed with a view to implementing the major elements of the federal budgetary reforms, and avoiding pro-cyclical spending at sub-federal levels. The recent enforcement of the sanctioning mechanism in the case of non-compliance with the targets set out in the DSP is welcome but implementation will be crucial. The focus of the DSP should be extended towards debt and spending targets. The medium-term expenditure framework should be applied at all levels of government.*

Budget processes should facilitate choices and ensure implementation

Generating the budget savings needed to safeguard Austria's fiscal position requires strategic decisions with strong political economy content, with respect to programme prioritisation, agreement on welfare provision and high-quality service delivery. The introduction of performance budgeting in 2013 offers the prospect of creating a more efficient budgeting process where prioritisation and performance checks make overall spending targets more achievable. It holds major promises in Austria, where many long-established spending programmes absorb large resources on a routine basis, with constituencies built up with vested interests in their continuation irrespective of social benefits and costs. *In order to facilitate the introduction of performance budgeting as planned, technical and preparatory work is necessary and needs to be undertaken as scheduled. Key policy objectives in the main public spending areas need to be defined, adequate performance indicators developed, and a clear procedure on how to use them in the concrete budgeting process has to be set out.*

Public spending needs to be substantially restrained

For the considerable consolidation effort to become least damaging for growth it is important to use the reformed fiscal framework in its fully rolled-out form. Containing public expenditure is the first-best option to durably consolidate public finances and prepare for upcoming fiscal challenges, given the above-average ratio of expenditures to GDP in Austria (53% in 2010, up from 49% before the crisis). Consolidation should concentrate on raising public sector efficiency, which can bring the public spending ratio down by 3 percentage points of GDP. OECD experience (in Germany for example) suggests that the most effective way to reduce public wage costs is to replace only a certain fraction of departures. The counterpart is the need for efficiency/productivity increases to preserve service quality.

Social spending should be better targeted

Scope for expenditure reductions also exists with respect to transfer spending. Austria is one of the highest spenders among OECD economies on social transfers, accounting for over 20% of GDP. The savings potential may be significant, not only in pension benefits, which is the largest component (see below), but also in other schemes such as transfers to families and housing subsidies. Better targeting of these programmes via means-testing would be justified, but acquired rights make this difficult. Yet a move in this direction will be hard to avoid if the generosity of benefits for those who need them is not to be severely reduced in the future.

Austria devotes a sizeable share of public social expenditures to pensions, partly because private pension provision plays a limited role, but also because Austrians retire much earlier and on more generous terms than most other OECD citizens. Early retirement continues to be relatively easy and even financially attractive, posing a heavy burden on those who continue to work. On unchanged policies, additional pension costs will be very high from 2020 onwards, when the “baby boom” generation retires and the old-age dependency ratio increases significantly. Another cost-driver of the current system is the existence of the separate pension schemes for civil servants at state and municipal level. While at the central government level pensions of civil servants are by now fully harmonised with the private sector, similar reforms at the state level have very long phase-in periods or have not started at all. *The government should eliminate all subsidised avenues into early retirement. Penalties for early retirement and benefits from continued work should be increased. The introduction in 2011 of measures for prevention and rehabilitation, as well as a tightening up of the precondition for the own-occupation assessment, should be closely monitored and the own-occupation based assessment of disability should be abolished if necessary. The pension schemes of the civil servants of states and municipalities should be fully harmonised and incorporation into the general pension scheme accelerated.*

The scope for efficiency gains needs to be identified sector-wide

In practice, resource savings need to be achieved in the context of individual programme demands and the potential for efficiency savings, with a view to maintaining service quality. In this context, Austria turns out to be one of the less efficient OECD countries in terms of value for money from health spending, suggesting that savings could be made (see below). Austria is also lagging with respect to the efficiency of education spending compared with international best practice, and could thus save resources without compromising educational outcomes. By contrast, Austria is spending marginally less on tertiary education than an average OECD country, although meeting the EU average. It is unlikely that more public financing will become available, *so that the issue of tuition fees should be reconsidered (see above).*

Growth-friendly capital spending should be maintained

Public investment cuts risk reducing growth in the long run. In considering investment projects, however, it is important to balance returns with costs. Adopting open tendering procedures can deliver substantial savings in government procurement. While the degree of

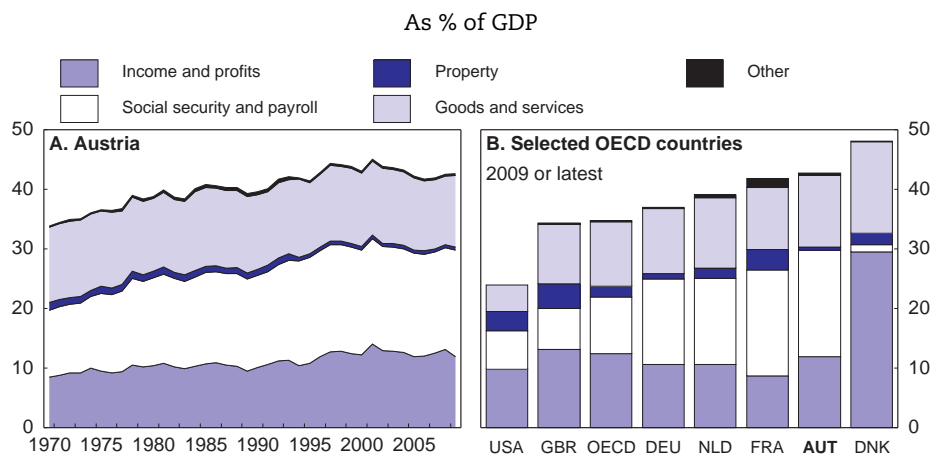
fiscal federalism within Austria might play some role in determining the size of individual procurement lots, *there seems to be considerable scope for Austria to increase the volume of its tendering processes.* Significant reductions in tender prices, together with more selective approach to the appraisal of public investment projects would help to contain public spending growth without compromising the growth-enhancing potential of government capital spending. *Public-Private Partnership (PPP) arrangements could also play an increasing role in delivering improved public services and infrastructure.* However, PPP options should be used only when there is a genuine efficiency gain or cost-effective risk transfer, and not as a device simply to keep government borrowing off-budget.

Tax burden should be moved away from labour

Despite some recent improvements, the tax structure continues to be biased towards distortive taxes on labour and entrepreneurship, while the share of growth-friendly taxes on immovable property and consumption is lower than in other OECD countries (Figure 8). Hence, there remains significant scope to make the tax structure more conducive to growth. *The tax system should be rebalanced with a view to increasing work incentives, encouraging investment entrepreneurship, and reducing tax-induced distortions.*

While average tax rates are high for almost all workers, marginal tax rates are particularly high at low income levels, due to the interaction of social security contributions, personal income tax and the benefit system. This reduces incentives for transition from inactivity to employment and from part to full-time employment. Priority should therefore be given to lowering the fiscal burden on low-skilled workers, who are most likely to respond to stronger work incentives. *This group of workers could be best helped by reducing social security contributions or introducing in-work benefits that top up wages.*

Figure 8. The tax structure is biased towards distortive taxes on labour



Source: OECD, Revenue Statistics database.

Tax increases in the consolidation package rightly concentrate on areas least harmful to growth

Budget consolidation relies to some extent on higher taxation, but the demand impact on the recovery is attenuated by a focus on increasing the taxation of environmental externalities, financial capital and capital gains. The switch towards greater reliance on capital taxes as part of a larger tax reform could be taken further by smoothing out other distortions. The share of property taxes is very low by international standards, mainly because land and building values have hardly been adjusted over the past decades.

Valuations of real estate and land should be brought to market values. Other taxes on property include inheritance and gift taxes which are also negligible in Austria, while OECD countries on average raise around 0.5% of GDP from this source. The Austrian tax reform process has gone in the opposite direction in recent years, with inheritance and gift taxes being allowed to expire in 2008 after the assessment of the tax base was ruled unconstitutional by the Constitutional Court. International practice differs greatly, but *the reinstatement of these taxes should be considered, within the wider context of a review of capital taxation in general.*

Box 1. Summary of fiscal policy recommendations

Develop a more forward-looking fiscal agenda

- Achieve more upfront consolidation in the next few years to bring the debt-to-GDP ratio below 60% by 2020. Medium- to long-term fiscal projections should be more instrumental in guiding front-loaded policy action. Increase transparency with regard to off-budget entities and contingent liabilities of the public sector.

Strengthen the fiscal framework at all levels of government

- Reinforce the current fiscal rule with a debt objective. In this context, specifying a target rate of growth of real general government spending would help.
- Reform the *Domestic Stability Pact* and the *Fiscal Equalisation Act* with a view to implementing expenditure frameworks at sub-federal levels.
- Performance budgeting should be applied at all levels of government.

Restrain public spending

- Reduce public wage costs by replacing only a fraction of retiring government employees. Seek efficiency gains in all major public spending areas, notably in the education and health care sectors. Strengthen tendering processes in public procurement. Use Public-Private Partnerships when there is a genuine efficiency gain.

Better target social and pension transfers

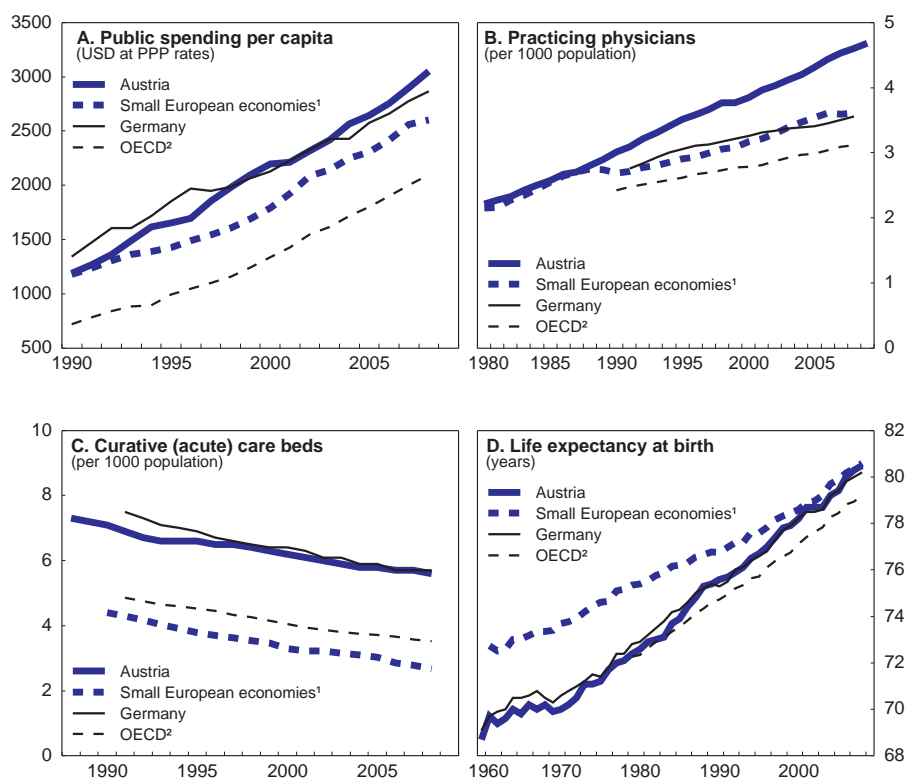
- Eliminate all subsidised avenues into early retirement.
- Increase the targeting of social transfers.

Make the tax structure more employment and growth friendly

- Rebalance the tax system with a view to increasing work incentives, encouraging investment and entrepreneurship, and reducing tax-induced distortions.
- Reinforce work incentives for low income workers by reducing social security contributions or introducing in-work benefits.
- Review the taxation of capital. Valuations of real estate and land should be brought to market values and the reinstatement of inheritance and gift taxes considered.

Austria dedicates very large public and total resources to health (Figure 9). The share of total health spending in GDP, at 11% is among the highest in OECD, mainly due to high public spending (8.5%). Health accounts for about 16% of total general government spending. The number of generalist and specialist physicians, and the number of acute care beds and high-technology medical equipment per capita are among the highest in OECD. The system performs well on some standard output indicators, like life expectancy, but not on others, like avoidable hospital admission rates. Life expectancy exceeds 80 years and has increased considerably. Citizens have become very attached to the existing health system, in particular its local delivery. However, maintaining the high level and quality of public health care will be a major challenge in the future, when a higher share of older people increases demand for health care services while reducing contributions to finance them. Against this backdrop, new national policy efforts to put public finances on a sustainable path put on the agenda a long disregarded question: are the large public resources dedicated to health being employed fully and adequately, and would it be possible to durably bend the growth of public health spending without undermining the quality and effectiveness of services?

Figure 9. Large resource commitments and strong outcomes



1. Arithmetic average of other small European high income economies: Denmark, the Netherlands, Sweden and Switzerland except the Netherlands in panel B.
2. Arithmetic average over OECD countries excluding: - Panel B: Chile, Ireland, the Netherlands, Portugal and Slovakia; - Panel C: Austria, Chile, Denmark, Germany, Greece, Luxembourg, Mexico, Norway, New Zealand, Portugal, Switzerland, Turkey and United Kingdom;

Source: OECD Health 2010 database and OECD calculations.

The health care system is organised along supply-side considerations

The Austrian health system is organised to deliver good quality and easily accessible services, but does not have clear mechanisms to optimise spending and service provision on a cost-benefit basis in order to achieve the best outcome for the population. This may be mainly due to the fact that it is a supply driven system. Social partners are in charge of the sickness funds and medical chambers with compulsory membership regulate the access to the system in outpatient care and pharmaceutical reimbursement. *Länder* are in charge of hospitals - without full cost responsibility. In contrast, the federal government finances a large share of costs without exerting any influence on the utilisation of the funds. This segmented financing structure weakens incentives for optimisation and perpetuates the dominance of service providers in the functioning of the system.

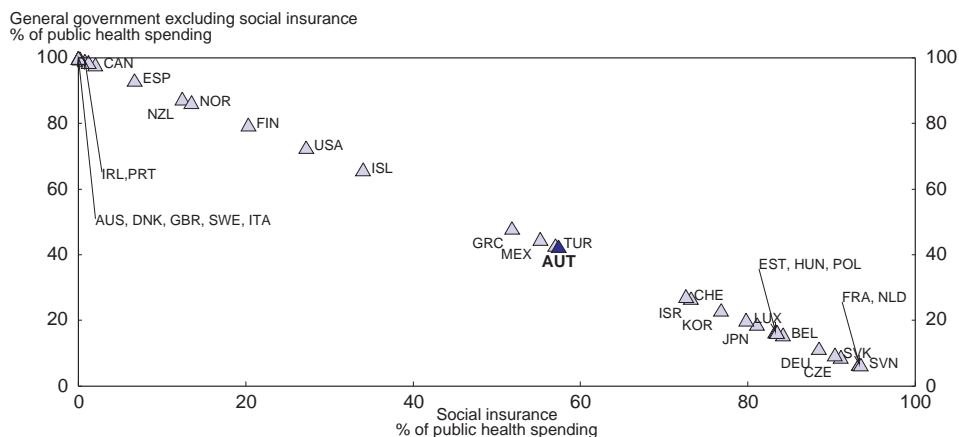
Entry and competition are *de facto* limited in markets for publicly-funded health services and goods. Most hospitals, particularly in less populated areas, are local monopolies. Ambulatory services by independent physicians are offered by “contracted networks” of generalists and specialists, which are co-managed by their respective professional associations, which exert monopolistic power. Pharmaceutical and other medical goods producers operate under restrictive regulatory frameworks which reduce competition. This may be one of the reasons behind the relatively limited, even though now rising, share of generic pharmaceutical products.

As a consequence of its supply-driven focus the Austrian health care system suffers from: *i)* a high degree of fragmentation; *ii)* an expensive “delivery-mix” with an overly strong focus on hospital services; *iii)* an overly large variation of outcomes; and *iv)* uneven quality control.

The institutional design of the system is too fragmented

Public health spending is divided between general government (42%) and social insurance funds (58%) (Figure 10). On the part of the government, Federal, *Länder* and municipal levels are simultaneously involved, to fund mainly hospital services. Social insurance funds other spending components: outpatient care by independent physicians, pharmaceutical costs, and part of the hospital costs. Each resident is registered with one of the 19 “Sickness Funds”, on basis of either region of residence or branch of employment. Funds offer somewhat different basic packages. There is only a rudimentary risk equalisation system between them (on basis of the age structure of membership) but no yardstick or direct competition. Funds are supposed to respect the budget envelope determined by revenues received from their members and contributions from central government.

Figure 10. The fragmented funding and governance structure



Source: OECD Health Data 2010.

The authorities are aware of these shortcomings, which reduce the responsiveness of the health system to policy objectives. The ultimate goal of a range of reforms introduced since 1997, and notably since 2005 and 2008, was to remedy some of the most severe institutional shortcomings and to make the health system more responsive to policy and market demands. Funding sources merged for better service purchasing. New payment mechanisms were introduced, emulating to some degree market signals, notably in the hospital sector (by directing funding for various services according to user demand). An important initiative is the endeavour to implement a detailed national capacity plan, which aims at remaining independent from existing supply structures, and means to anticipate future demand for services. These efforts have all been helpful, but do not seem to have altered the basic institutional flaws of the system. To address them, this *Survey* suggests that *public resources dedicated to health should be further consolidated and be given clear objectives, i.e. performance, financing and spending responsibilities should be much more clearly assigned in the national health system. The national capacity plan for publicly-funded inpatient and outpatient care should be optimized and enforced under federal government authority, with the support of the Länder governments and Sickness Funds. This recommendation may face constitutional obstacles. In such instances, “joint funds” or “fund pools” consolidating resources from different general government entities may prove useful. To increase policy leverage, the high fragmentation of the social insurance sector should also be overcome. One possible step is to reduce the number of funds by merging them.*

The system remains too heavily centred on hospital services

The health system is heavily centred on inpatient services, which are mostly provided by hospitals and are expensive. As the costs of both inpatient and outpatient care provided by hospitals are largely funded by the government, Sickness Funds - which finance a variety of alternative services - have a distorted view of hospital costs, and no incentive to take them fully into account. At the same time, *Länder* governments have an interest in maintaining hospital capacity at high levels. Residents appreciate round-the-clock hospital services near where they live, and make intensive use of them.

The health system could provide quality care at lower cost by making greater use of family doctors, outpatient, inpatient, rehabilitation and long-term care. The prevailing fragmentation and firewalls in both funding and provision have hampered adjustment. There have been important *ad hoc* policy initiatives to develop integrated services and to better balance outpatient and inpatient services, and certain produced very good results - such as the disease management programme (DMPs) for diabetes - but they have not modified the inpatient focus of the system. An electronic health record infrastructure is being put in place (the so-called ELGA system) which is destined to help optimise patient-level care in the future. Other countries' experiences indicate that more supportive mechanisms for funding, contracting and paying for integrated services are important for more spontaneous and faster development of integrated care. This *Survey* suggests that the authorities should; *i) continue to back disease management programmes and diffuse best practices in all chronic care areas; ii) remove legal restrictions for group practices, and for the outpatient departments of hospitals which could become autonomous entities; and iii) authorise Sickness Funds to enter into “managed care” agreements with group practices and outpatient clinics. Policymakers should also continue to give high priority to the development of the individual electronic health record-based ELGA system.*

Access remains equitable but health outcomes differ across social groups

All indicators confirm that the degree of equity in accessing services is among the highest in OECD. In contrast, there is evidence that life-style choices and a lack of prevention are becoming significant sources of differentiation in health status across social groups and regions. In particular, gaps experienced in these areas by immigrant groups with a low level of education are important. Differences are also large across *Länder*. These gaps are particularly worrying concerning cases of overweight citizens and obesity, notably at younger ages, which have serious long-term health and cost implications. If these non-health care factors do not improve, health outcomes risk diverging more in the future

than in the past, and overall performance will fall short of potential. *Austria should: i) set national health goals, and pursue them by a better balance between lifestyle improvement, prevention and curative care; ii) implement more effective public health programmes with respect to nutrition, smoking and alcohol consumption; iii) continue to develop “children’s health” programmes which have positive life-long impacts; and iv) develop special programmes for vulnerable groups lagging behind in positive lifestyle choices and prevention, notably low education immigrant and resident groups.*

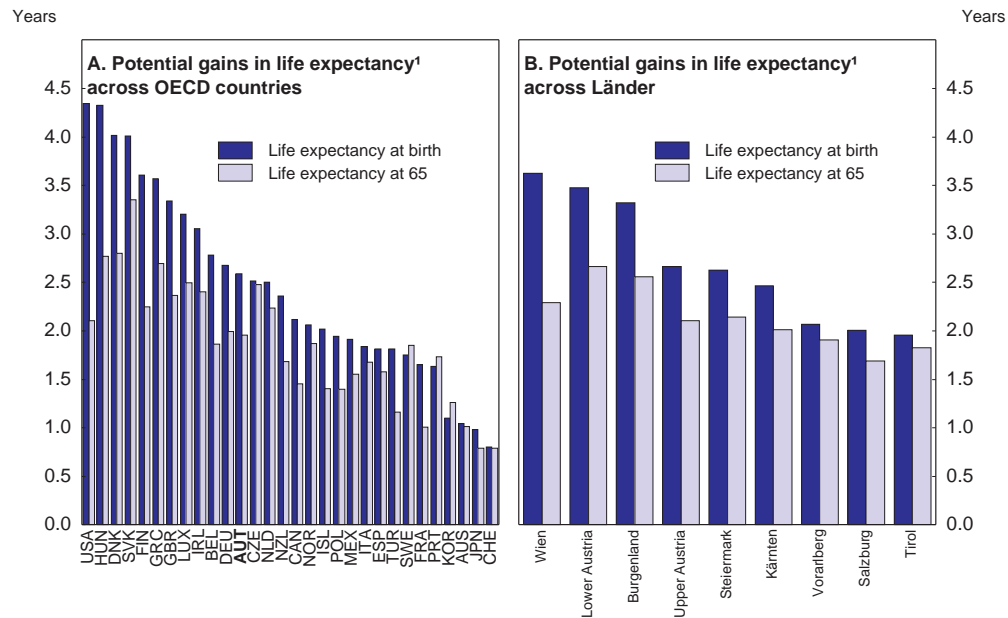
The quality of services should be made more transparent

There is a widespread perception that the quality of health services is very high and homogenous across the country. Health experts and government officials observe however that this assertion is not necessarily backed by objective criteria. Some international indicators indicate that Austria succeeded in reducing mortality rates from certain prevalent diseases to well below OECD averages, and below averages in other high-income countries such as Sweden, Denmark and Netherlands. In other areas outcomes are average. There are also matters where Austria has fallen short, such as standard vaccination procedures and related outcomes, including hepatitis incidence. Policymakers are aware of the need to considerably strengthen the monitoring of quality performance and introduced an “Austrian Quality Strategy” as part of a reform package in 2005. A *Federal Institute for Quality in the Health Care System* was created, inspired by the system of quality indicators successfully put in place in Germany. National quality reports were to be prepared on all sectors and professions according to uniform methods. This work was also to help improve quality outcomes by individual care providers. However, this project could not be implemented, and quality reporting as requested by Law has not yet come through. *The authorities should fully put in application the national quality strategy, if needed on the basis of a stronger legal and regulatory framework.*

There is large room for efficiency gains

A main policy objective is to enhance the economic efficiency of the system. Recent research helped document more clearly significant economic inefficiencies, e.g. services are not produced at the lowest possible input volumes and costs. International comparisons of health system efficiency, efficiency reviews in the hospital sector, and inter regional comparisons of resource utilisation in different *Länder* corroborate this diagnosis (Figure 11). The authorities basically concur with these analyses and have phased in initiatives to help raise efficiency. Additional planning objectives have been introduced to better align resources with service needs; hospital payments aim at tracking benchmark productivity and cost levels, a new health technology assessment system aims at better balancing costs and benefits in drug utilisation. The *Survey* suggests that policymakers should focus on the three main triggers of productivity improvement: financing services according to strict quality and cost criteria; relying more on competition; and, when services are provided by national or local monopolies - notably when negotiating with medical chambers - using strict cost benchmarks and yardstick competition. *They should: i) eliminate the firewalls between physicians’ services and hospitals’ outpatient wards and contract with both for ambulatory care (for more user choice and competition); ii) base fee negotiations with all ambulatory care providers on more innovative and cost-saving techniques (to make fees converge with benchmark cost levels); iii) fully implement the cost-based Diagnosis Related Group (DRG) system on all inpatient services, and, in a next step - after a fundamental change of financing structures -, make Sickness Funds pay the full costs of inpatient care; iv) close the loopholes which permit DRG payments to deviate from national cost benchmarks on a regional basis; and v) increase competition in the pharmaceutical market by submitting not only new but also the existing “stock” of drugs to health technology assessment, and by authorising additional generic products when possible.*

Figure 11. There is important room for efficiency gains



1. DEA efficiency calculations were performed with two inputs: health care spending per capita and a variable which is a composite indicator of the socio-economic environment (GDP per capita, educational attainment) and lifestyle factors (nitrogen oxide emissions, consumption of fruit and vegetables, lagged consumption of alcohol and tobacco - 1990 data).

Source: OECD.

Short-term spending savings are welcome but should be made more structural

All policy efforts in the area of health should remain compatible with broad economic and fiscal policies. As discussed above Austria has a compelling short-term fiscal consolidation task. Health and economic policymakers agreed to solicit the health system for immediate savings. In 2009, a sizeable saving package was agreed with Sickness Funds, entailing spending restraint for prescription drugs (negotiated with pharmaceutical manufacturers) and for ambulatory care (negotiated with medical chambers). Hospital care, which is the largest spending item but where governance and spending responsibility lies largely with *Länder* governments, was left out. Early evidence suggest that this saving package will reach and overperform its immediate targets, but there are some indications, in line with past experience, that savings may remain cyclical and spending could resume its trend growth when the economy recovers. *The authorities should aim at achieving less short-term and more structural savings, in particular in hospital care.*

The medium-term fiscal outlook of the health system needs to become more prominent

Public health spending faces major long-term pressures. As in other OECD countries, they arise from the ageing of the population, technological progress and associated health care opportunities, and increases in the relative prices of medical goods and services. However, they are compounded by three features of the national health system: *i)* the wider scope of the legally-guaranteed health package, and its openness to state-of-the-art goods and services; *ii)* the system's commitment to take responsibility for the disability care needs of dependant persons, irrespective of their financial means, and *iii)* health price increases which have been steeper to date than in other countries. As a result, existing public health spending projections vary markedly, and reach up to 2 percentage points of GDP of further

public health spending by 2020, and 5 percentage points of further spending by 2030. In this environment, a common framework of medium-term fiscal scenarios, and outlook, between health policymakers and economic policymakers would be very useful.

This *Economic Survey* suggests: i) to make the official health and long-term care spending projections (presently produced under the aegis of the European Commission) more nationally visible; ii) integrate better the “health care” and “long-term care” components; iii) to produce national spending scenarios, with a the full range of hypotheses on the impact of technological change and future demands for new services; iii) set a medium-term (10-15 years) path for public health spending at general government level; and v) consider making public health spending at general government level a policy target associated with the multi-year budget framework which accompanies the annual budget law. These initiatives would help implement health policies in full congruence with the Austrian government’s economic policy goals, including fiscal sustainability and growth.

Box 2. Summary of health policy recommendations

Tighten the institutional design of the health system

- Performance, financing and spending responsibilities should be much more clearly assigned.
- The national capacity plan for publicly-funded inpatient and outpatient care should be optimized and enforced under federal government authority, with the support of the *Länder* governments and Sickness Funds.
- This recommendation may face constitutional obstacles. In such instances, “joint funds” or “fund pools” consolidating resources from different general government entities may prove useful.
- The fragmentation of the social insurance sector should be reduced.
- The Federation of Sickness Funds (*Hauptverband*) should continue to centralise functions where there are economies of scale.

Mobilise performance-based payment mechanisms to improve productivity

- Eliminate the firewalls between physicians’ services and hospitals’ outpatient wards and contract with both for ambulatory care. Base fee negotiations with all ambulatory care providers on more innovative cost-saving techniques. Aim at gradually expanding the cost-based hospital payment DRG system into outpatient care.
- Fully implement the DRG system on all inpatient services and close the deviations of DRG payments from national cost benchmarks.
- Increase competition in the pharmaceutical market by submitting also the existing stock of drugs to health technology assessment, and by authorizing additional generic products when possible.

Emphasise national health and quality goals

- Set national health goals including quantified targets. Pursue them by a better balance between lifestyle improvement, prevention and curative care.
- Make public health programmes more effective. Continue to develop “children health”

programmes.

- Develop special programmes for vulnerable groups which lag behind in lifestyles and prevention.
- Implement fully the national quality strategy in the entire range of health services, if necessary on a stronger legal and regulatory basis.

Promote better-balanced integrated care

- Continue to back disease management programmes, especially in all chronic care areas.
- Remove legal restrictions for group practices, and for the outpatient departments of hospitals which could become autonomous entities.
- Authorise Sickness Funds to enter into managed care agreements with polyvalent group practices and outpatient clinics.
- Continue to give high priority to the individual electronic health record-based ELGA system.

Make the medium-term fiscal outlook of the system more prominent

- Focus the post-crisis spending saving measures on structural areas, also in the hospital sector.
- Make health and long-term care spending projections and scenarios more nationally visible.
- Integrate better the “health care” and “long-term care” components of projections.
- Set a medium-term (10-15 years) path for public health spending at general government level.
- Consider making public health spending at general government level a policy target.

Chapter summaries

Chapter 1. Public sector inefficiencies have become less affordable

Performance of fiscal policy, while good in international comparison, is not sufficient to prepare for future ageing related spending increases. Given favourable macroeconomic conditions, the pace of consolidation could be more ambitious than currently planned, with a view to reducing the debt burden below 60% of GDP by 2020. Austrian fiscal policies have tended to be pro-cyclical in upturns, mainly because spending was not adequately kept in check. Stronger fiscal rules and a reform of inter-governmental fiscal relations could help contain expenditure dynamics. Efficiency-raising reforms in key spending areas such as pensions and other social expenditures, health, and education are also highly needed to reduce spending and ensure the provision of high-quality public services at lower cost. In this regard, Austria should make full use of the performance budgeting framework it plans to introduce from 2013. Higher potential growth could also take off some of the pressure on public finances. There remains significant room to rebalance the tax structure towards less distortive sources of revenue, thus supporting employment and growth.

Chapter 2. Reforming a highly regarded but costly health system

The highly regarded Austrian health system delivers good quality and easily accessible services, but is costly. Its governance and funding structure is highly fragmented and it makes too much use of inpatient care in hospitals. Entry and competition opportunities are de facto limited in most health markets. The system operates therefore on a supply-driven basis, and does not have clear mechanisms to optimize spending on a cost-benefit basis. Population lifestyles are also not supportive of good health outcomes and suffer important differences between social groups, raising risks for the future. This Chapter reviews Austrian authorities' responses to these challenges, and makes recommendations based on OECD countries' experiences. The suggested priorities are: i) more clearly assigning the performance, financing and spending responsibilities in the system, ii) enforcing a national capacity plan for publicly-funded inpatient and outpatient care, iii) introducing performance-based payment mechanisms in all services, iv) promoting the transition to "integrated care" by better balancing preventive, outpatient, inpatient, rehabilitation and long-term care, and v) better clarifying the medium-term fiscal outlook and scenarios of the system.

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Austria were reviewed by the Committee on 16 June 2011. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 27 June 2011.

The Secretariat's draft report was prepared for the Committee by Rauf Gönenç, Oliver Röhn and Karin Fischer, under the supervision of Andreas Wörgötter. Background work for the labour market and financial sector sections of the Assessment and Recommendations was drafted by Caroline Klein, Felix Hüfner and Artur Radziwill. Research assistance was provided by Béatrice Guérard. The Survey also benefited from external consultancy work by Maria Hofmarcher and Robert Price

The previous Survey of Austria was issued in July 2009.

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See also <http://www.oecd.org/eco/surveys/Austria>.

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