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# Austria’s old coalition faces harsh realities

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Back in power: Werner Faymann, Austria’s chancellor and leader of the Social Democrats, following the election result

Election years are not traditionally a time when governments show their reformist zeal and the past 12 months in Austria have been no exception.

Yet, despite a period of political stasis, the most likely outcome of the negotiations following September’s general election is another instalment of the grand coalition that has dominated Austrian politics, business and civic life since the end of the second world war.

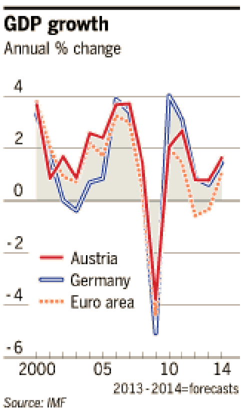
This latest incarnation will enjoy a smaller mandate than any of its predecessors. As recently as 2002, the centre-left Social Democrats and the centre-right People’s party won 78.8 per cent of the vote between them. This time around, they managed 50.8 per cent.

In some respects, this electoral verdict might seem a little harsh. After all, in macroeconomic terms, Austria is more or less a eurozone success story. The landlocked Alpine country enjoys the lowest unemployment rate in the currency bloc, the second highest per-capita income after Luxembourg and relatively little inequality.

It has managed to post growth every year since 2009 and pays lower interest rates on its debt than most of its peers. Its big banks, Erste Group, Raiffeisen Bank International and Bank Austria, are stable despite their strong exposure to the volatile central and eastern European region. On the streets of Vienna – and even in far-flung villages – there is an atmosphere of prosperity that is found all too rarely in other European countries these days.

But, beneath this sheen of well-being, various structural problems are beginning to demand attention.

Domestic observers warn of a loss of competitiveness and fret that, without large-scale reforms, this hard-won prosperity could be eroded in the medium term.




“The current macroeconomic picture looks good, but if you look at long-term growth trends, then Austria is at a turning point”, says Christian Keuschnigg, director of the Institute for Advanced Studies in Vienna.

Among the main weak points, he says, are: some of the highest tax rates in the EU; underfunded and overly bureaucratic universities; an overbearing and often overlapping bureaucracy; a lack of venture capital; and a generous pension system that offers one of the world’s highest replacement rates, combined with an extremely low retirement age.

Josef Christl, a former executive director of the Austrian national bank who is now a consultant, highlights the plight of Austria’s capital markets. They flourished in the boom days before 2007 but have since seen volumes fall, prompting the Vienna stock exchange to discuss co-operation with the Warsaw bourse.

“Improving the capital markets is crucial,” says Mr Christl. “Whether the main exchange is located in Warsaw or Vienna is not really the most important point. What matters is that companies are able to get access to enough capital to meet their needs."

As well as the structural questions, the new government faces the more immediate challenge of dealing with three midsized banks that were nationalised to varying degrees after running into difficulty during the financial crisis.

Most observers, including the IMF, agree that the cost of dealing with the distressed trio – Hypo Alpe-Adria-Bank International, Kommunalkredit, and Österreichische Volksbanken – will be manageable. But it will not be cheap. The EU has given Austria permission to spend a further €5.7bn just to sort out Hypo, and pessimistic observers think the bill could rise further.

Both the immediate banking and the slower-burning structural problems are well-known.

Indeed, the latter have been the subject of dozens of reform blueprints over the years. The coalition government has failed to address them, and this failure largely explains its persistent decline in popularity.

"If you want to build an attractive climate for companies to invest in, you need clear decisions on key issues such as taxation, not endless talking," says Andreas Treichl, the chief executive of Erste Group. "Hopefully, that's going to change. The past 12 months have been very unfortunate."

The flipside of the coalition's woes was a strong showing in September's election by Austria's panoply of protest parties. Between them, they garnered more than 30 per cent of the vote.

The largest remains the far-right Freedom party, which boosted its share of the vote from 17 to 20.5 per cent.

Discontent with the status quo was also clear in the success of two newly founded parties: Neos, a centrist grouping that won 5 per cent of the vote; and a new party set up by billionaire Frank Stronach, which received 5.7 per cent but then started to disintegrate right after the ballot.

The Greens won 12.4 per cent. This was an improvement on 2008 but not enough to form a left-leaning government with the Social Democrats, which remained the biggest party with 26.8 per cent, ahead of the People's party, which won 24 per cent.

With the Freedom party unacceptable as a coalition partner because of its xenophobic and anti-European programme, the election outcome effectively forces the Social Democrats and People's party to continue their unhappy cohabitation.

"It's not a marriage of love, it's not even a marriage of convenience, it's a marriage of necessity," says Anton Pelinka, professor of political science at the Central European university in Budapest.

The influential president of the federal chamber of commerce, Christoph Leitl, captured the concern over Austria's current course when, at the height of the election campaign, he said the country, as a business location, was "dilapidated".

The comment caused uproar among political leaders, including Social Democratic chancellor Werner Faymann, who warned against bad-mouthing the country's strong economic performance.

It is true that Austria has slipped in most of the key international rankings, including the Davos World Economic Forum and the Lausanne-based IMD.

Vienna is widely cited as the city with the highest quality of life for expatriates, but not as a great place to start a business.

Taxes and non-wage labour costs are high and environmental and workplace regulations are relatively strict.

Despite the strengths of Austria's traditional apprentice system in helping most young people find a job, some companies struggle to find qualified workers, as more and more students leave the public school system with low literacy and numeracy skills.

Pensions, healthcare and other social programmes gobble up 30 per cent of gross domestic product. The government's take of annual output is about 44.6 per cent, one of the highest in Europe.

In light of these numbers, there ought to be ample room to invest in infrastructure, research and education, critics say.

"Too much money flows into current welfare programmes, and even there, too many gaps remain," says Mr Keuschnigg.

For the next generation, he warns, the prospects will be far less rosy.