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Austrian coalition seeks to finance promised tax reduction

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Tax cuts do not often unite the political spectrum. But in Austria, both left- and rightwing parties agree that the income tax burden needs to be reduced. How the debate develops is likely to be one of the main political features of 2015.

At the moment, the Austrian income tax system has four bands. Those earning less than €11,000 per year pay nothing. On incomes between €11,000 and €25,000, a tax of 36.5 per cent is levied. Between €25,000 and €60,000, workers pay 43.2 per cent. And above €60,000, the rate is 50 per cent.

Non-wage labour costs are high in comparison with other countries. Between them, taxes and social security contributions make up 49.1 per cent of total labour costs in Austria, far above the average of 35.9 per cent in countries that belong to the OECD.

"There is a disproportionately high burden on labour," says Christian Keuschnigg, professor of economics at the University of St Gallen. "This is something that needs to be corrected."

The coalition government – composed of the centre-left Social Democrats (SPÖ) and centre-right People's Party (ÖVP) – agreed in September that it would cut the income tax burden by at least €5bn per year. Much of this will come from reducing the entry tax rate from 36.5 per cent to 25 per cent.

However, the big question hanging over the government's reform plans – which are due to be unveiled by March – is how the tax cuts will be financed.

A proposal from the Austrian Federation of Trade Unions (ÖGB), which the Social Democrats have used as a basis for their negotiations with the People's Party, argued that the cuts could be financed through a mixture of wealth taxes, closing loopholes in the existing tax code, and measures to combat tax evasion.

In addition, the ÖGB claims, the cuts would partly finance themselves, as the lower tax burden would leave workers with more cash in their pockets, boosting consumption and thus government receipts from other tax streams.

"This is particularly the case because the reduction will, above all, affect people on low wages most, and they have a propensity to spend a high percentage of their income," says Bernhard Achitz, chief secretary of the ÖGB.

For the moment, however, it is unclear how realistic those suggestions are. The ÖVP is not keen on taxes on wealth or inheritance. One of the main loopholes in the Austrian tax code – which exempts the so-called 13th and 14th salary payments Austrians receive each year from tax – seems unlikely to be plugged. The proceeds of tax evasion crackdowns are notoriously hard to estimate. And economists caution against relying on tax cuts to finance themselves.

"There is certainly such an effect, but I wouldn't base my fiscal strategy on such revenues," says Mr Keuschnigg. "It leaves no room for manoeuvre if the economy slows or things go wrong."

Some observers question whether €5bn worth of income tax cuts will be large enough to have a significant economic impact. "It's better than nothing, but still far too little," says Josef Christl, a consultant and former executive director of the Austrian central bank.

"The planned reduction would offset the extent to which inflation has pushed people into higher tax brackets over the last four or five years, but it wouldn't really have a big impact on taxpayers' finances," he adds.

Christoph Neumayer, secretary-general of the Industrial Association, a business lobby, takes a similar line. "We understand the constraints the government is under," he says, alluding to the pressure the EU is putting on member states to cut their budget deficits. "But this is the lower boundary as far as we are concerned."

Spending cuts are vital if Austria is to put its finances on a stable footing in the medium term

The Industrial Association has laid out its own proposals for a €15bn cut in taxes, made up mainly of a

€10bn reform of income tax and a €4.7bn reduction in non-wage labour costs.

While the ÖGB is essentially arguing for a redistribution of the tax burden, the Industrial Association's proposed tax reform is designed to shrink the size of the state, as well as cutting income taxes.

To finance its proposed tax cuts, the Association proposes shrinking Austria's multi-layered bureaucracy, cutting subsidies, and reforming the health and pension systems.

Such changes would help bring down the overall tax take, which, at 45.3 per cent of national income, is the fifth-highest in the EU. But they are politically unlikely: despite numerous blueprints over the years, reforms on this scale have proved elusive in Austria.

Mr Neumayer acknowledges the difficulty, but insists that spending cuts are key if the country is to put its finances on a stable footing in the medium term: "Austria doesn't have a revenue problem – tax revenues were up 3.3 per cent in 2013 – it has a spending problem. That is what we need to get a grip on.

"Of course a reform of bureaucracy has long been spoken of without much success, but if there is a way for Austria to become more competitive, then this is it," Mr Neumayer adds.