FOR AGENDA

SM/13/243

August 20, 2013

To: Members of the Executive Board

From: The Secretary

Subject: **Austria—Selected Issues**

This paper provides background information to the staff report on the 2013 Article IV consultation discussions with Austria (SM/13/241, 8/20/13), which is tentatively scheduled for discussion on **Wednesday, September 4, 2013.** Unless an objection from the authorities of Austria is received prior to the conclusion of the Board's consideration, the document will be published. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Ms. Detragiache (ext. 36376) and Mr. Steinlein (ext. 37320) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Central Bank forthwith; to the WTO Secretariat on Wednesday, August 28, 2013; and to the European Commission, the Food and Agriculture Organization, and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

AUSTRIA

SELECTED ISSUES

August 16, 2013

Approved By
European Department

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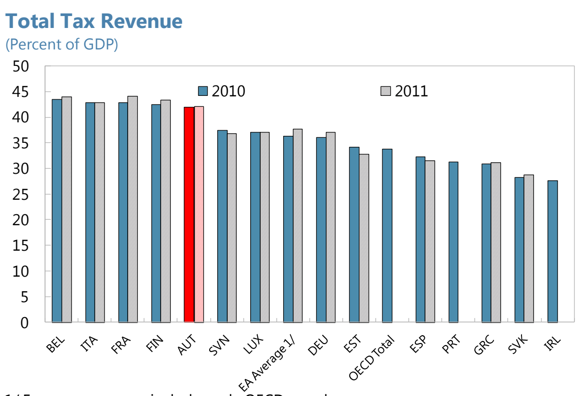
CONTENTS

MAKING WORK PAY AND INCREASING FEMALE LABOR SUPPLY

Austria taxes labor heavily and this explains in particular the limited labor supply of low-skilled workers and women. Child care costs may have additional disincentive effects for female labor supply, and family benefits, albeit high, are not designed in a way that sufficiently mitigates these effects. A reallocation of monetary family benefits to the provision of high-quality and affordable childcare facilities would offer women more incentives to increase labor supply.

A. Starting Point: High Labor Taxation and Family Benefits

1. Austria has a relatively high overall tax burden and taxes labor especially heavily.[1] In fact, its share of labor taxes in total taxation is the highest in the euro area.



1/ Euro area average includes only OECD members.
Source: OECD.

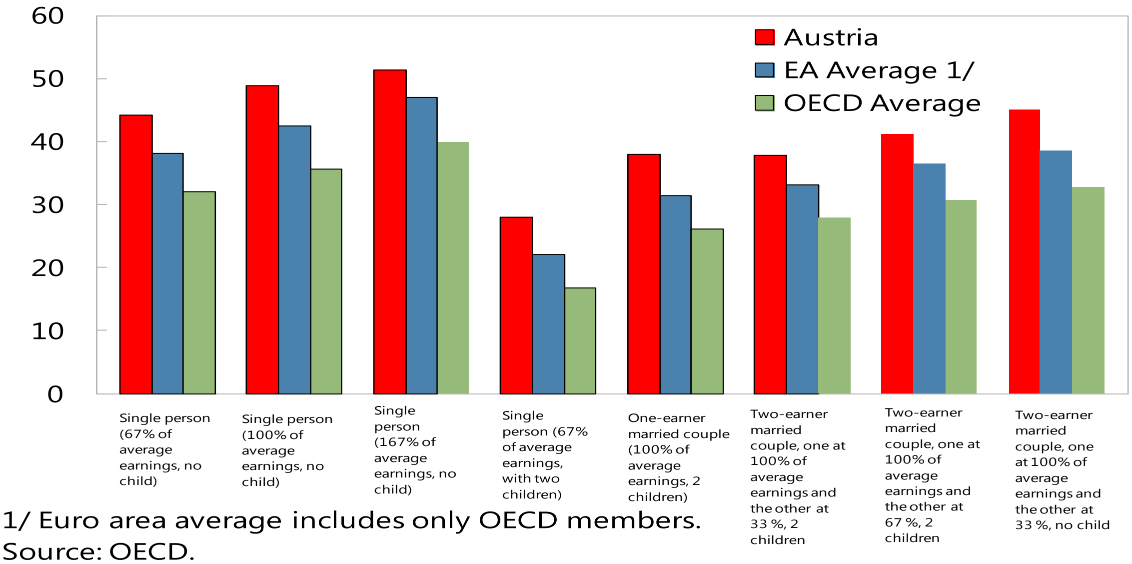
Source: Commission services.

2. Correspondingly, Austria is among the countries with the highest tax wedges in the OECD (*see text chart*).[2] Furthermore, Austria is one of the few OECD countries in which tax wedges are now more elevated than in 2000.

[1] See also Annex III of the 2012 IMF Staff Report, which includes model-based estimates of growth effects of a reduction in labor taxation.

[2] The "tax wedge" measures the difference between labor cost for the employer and the corresponding net take-home pay of the employee. This difference is expressed as percent of labor cost. The difference comprises personal income tax and social security contributions paid by employees, social security contributions and payroll taxes paid by employers, minus standard cash benefits received by the analyzed family types.

Average Tax Wedge across Family Types, 2012
(Percent)



1/ Euro area average includes only OECD members.
Source: OECD.

3. **The share of family benefits in GDP is also on the high side.** This holds with respect to both the OECD and the euro area, with monetary transfers particularly elevated (*see text chart on page 4*).

B. Key Parameters of Labor Taxation and Family Benefits

Social security contributions and payroll taxes

4. **Social security contributions and payroll taxes amount to almost 50 percent of gross monthly wages.** More than 18 percentage points are paid by employees and more than 31 percentage points by employers (see text table). Most social security contributions start at a minimum monthly income threshold of EUR 387 and are capped at EUR 4.440.

Social Security Contributions and Payroll Taxes
(In percent of gross wages)

	Employee	Employer
Health insurance	3.95	3.70
Unemployment insurance 1/	3.00	3.00
Pension insurance	10.25	12.55
Accident insurance	0.00	1.40
Contribution labor chamber	0.50	0.00
Contribution residential building fund	0.50	0.50
Contribution bankruptcy fund	0.00	0.55
Contribution funds for severance payments, etc. 2/	0.00	1.53
Contribution to Chamber of Commerce 3/ 4/	0.00	0.55
Contribution to "Family Burden Equalization Fund" 4/	0.00	4.50
Community Tax 4/	0.00	3.00
Total	**18.20**	**31.28**

Source: Austrian authorities.

1/ The contribution to unemployment insurance by employees is zero up to monthly earnings of EUR 1,219; 1% up to EUR 1,330; and 2% up to EUR 1,497.
2/ For employees hired after 2002 (or when both employer and employee opted in); not subject to minimum income threshold and cap.
3/ average across federal states.
4/ levied on the monthly sum of gross wages paid by an employer (unless this sum does not exceed EUR 1,095).

Income taxation

5. Income taxation starts at a relatively high level of income, with a comparatively high statutory tax rate.[3] The first income tax bracket starts at roughly 40 percent of the average gross income and the marginal rate is 36.5 percent (*text table*).[4] Marginal income tax rates are to a large extent independent of the marital status as the Austrian income tax system applies individual taxation.[5]

Income Tax (statutory)
(In percent)

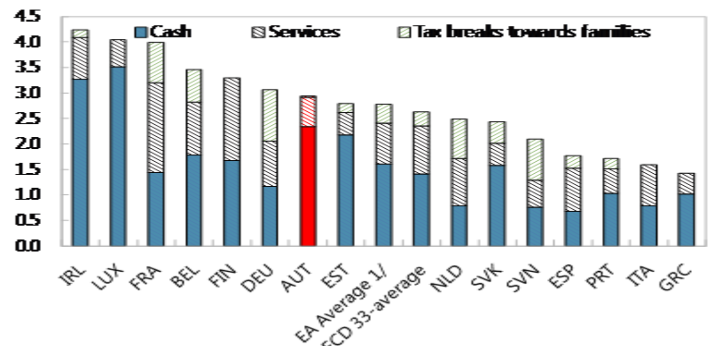
Tax Brackets	Tax Rate
up to EUR11,000	0.0
EUR11,000 – 25,000	36.5
EUR25,000 – 60,000	43.2
above EUR60,000	50.0

Source: Austrian authorities.

Family benefits

6. The family benefit system is complex. A comparatively high share of Austria's family benefits is monetary rather than in kind. Of this, the bulk consists of unconditional cash transfers. These benefits are paid to all parents regardless of their in-work status and regardless of their income level.

Public Spending on Family Benefits, 2009
(Percent of GDP)



1/ Euro area average includes only OECD members.
Source: OECD; and IMF staff calculations.

[3] Payments in addition to regular monthly salaries (such as customary leave and Christmas bonuses) are subject to lower taxation as long as they do not exceed one sixth of the annual gross salary. This shifts the tax rates down. For instance, if leave and Christmas bonus correspond to one regular monthly salary each, the rate for the first bracket is approximately 32 percent.

[4] Taxable income excludes in particular social security contributions.

[5] There are limited exceptions to individual taxation such as the "sole earner tax credit", which amounts to EUR 364 per year (plus EUR 130 for the first child, EUR 175 for the second, and EUR 220 for the third and subsequent child) and is granted as long as partner income does not exceed EUR 6000 per year. In spite of its relatively small amount, it could nevertheless play a role when it comes to labor supply decisions of low-income secondary earners.

7. The major cash transfers are the following:

(a) *child/family transfer ("Familienbeihilfe")* in monthly amounts between EUR 105 (up to the age of three) and EUR 153 (up to a maximum age of 25 for students or professional trainees).[6] Monthly increments are available for the second child (EUR 13), third child (additional EUR 35), and fourth and subsequent child (additional EUR 50). There is an additional family allowance of EUR 20 per month for the third and subsequent child if the (modified) taxable family income did not exceed EUR 55,000 in the preceding year; and there is a 13th family allowance of EUR 100 per child between 6 and 15 paid every September at the start of the school year.

(b) *child "tax credit"* that amounts to EUR 58.40 per child and month**.** In actuality, this is a cash transfer that is independent of any tax liability and paid together with (a).

(c) *childcare transfer* that can be claimed in one of five variants**:** Four of these variants are lump-sum transfers, i.e. independent from any income before child birth. However, they allow for additional income during benefit receipt of up to 60 percent of any pre-birth earnings or at least EUR 16,200 annually. The four lump-sum options differ in duration and amount:

- in *variant (1)*, the duration is 30 months (or 36 months if the father also takes advantage of the benefit for part of the time) and the monthly amount is EUR 436;

- in *variant (2)*, the duration is 20 months (or 24 months if the father also participates) and the monthly amount is EUR 624;

- in variant (3), the duration is 15 months (or 18 months if the father also benefits) and the monthly amount is EUR 800;

- and in *variant (4)*, the duration is 12 months (or 14 months if the father takes part) and the monthly amount is EUR 1,000;

In all four variants above, parents with low income (below an annual EUR 6,100 for the benefitting parent and EUR 16,200 for the partner) can apply for an additional EUR 180 per month for a period of 12 months.

The *fifth variant* is conditional on pre-birth employment. In this option, the benefit is 80 percent of pre-birth income, with a maximum amount of EUR 2,000. The duration

[6] Students/trainees can receive child transfers as long as their annual (modified) taxable income does not exceed EUR 10,000.

of the benefit is 12 months (or 14 months if the father takes advantage of is as well). The limit for any additional income during benefit receipt is lower than in the lump sum variants, at EUR 6,100 annually.

(d) *A birth-related transfer ("Wochengeld")* that is paid by health insurance for the period of between eight weeks before and eight weeks after giving birth, substituting for the mother's net income during that time.

8. In addition, there exist several smaller family benefit programs. These are administered across various federal ministries, or are separate programs at the state level.[7]

9. The standard tax allowance for children is small.[8] A more substantial tax relief relates to actually incurred child care costs that are deductible from the tax base up to an annual amount of EUR 2,300 per child until the age of ten. With the same age limit, employer contributions to child care cost up to an amount of EUR 500 per year are tax- and social contribution-free.

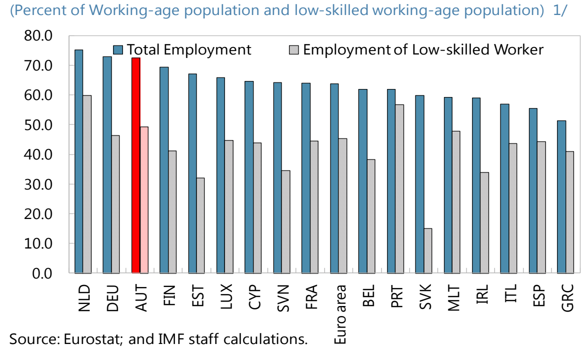
C. Effects on Work Incentives

10. The high marginal burden on labor income even at the low end helps explain the following characteristics of the Austrian labor market: (a) compared to overall employment, a relatively low employment rate among the low-skilled (*text chart*); and (b) a high share of part-time work, in particular among women (*text chart*). A third feature of the labor market, the low employment rate among older workers is not discussed here as it mirrors to a large extent relatively generous early retirement benefits and, at least for women, a low statutory retirement age.[9]

Low-skilled workers

11. High social contributions and entry income tax rates are likely to hamper work incentives for individuals with low earnings potential, including through the interaction with the social benefit system. This has already been pointed out in previous IMF staff reports.[10] For instance, beneficiaries of the means-tested

Total and Low-Skilled Employment
(Percent of Working-age population and low-skilled working-age population) 1/



Source: Eurostat; and IMF staff calculations.
/1 "Low-skilled": Pre-primary, primary, and lower secondary education

[7] For an overview, see the report of the Austrian Court of Auditors "Familienbezogene Leistungen des Bundes und ausgewaehlter Laender", Bund 2011/6, Wien 2011.

[8] The standard annual tax allowance deductible from the tax base currently amounts to EUR 220 per child (if claimed by only one parent) or EUR 132 per child for each parent (if claimed by both).

[9] See 2011 and 2012 IMF Staff Reports.

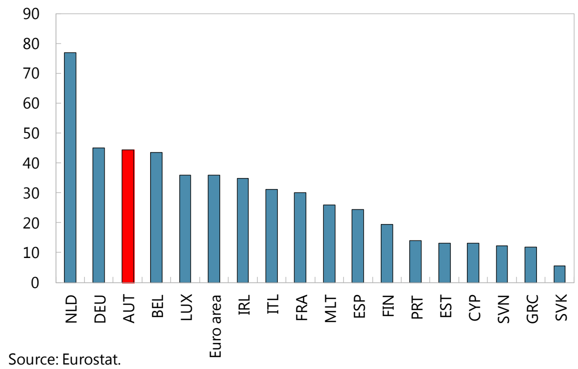
[10] See Annex III of the 2012 IMF Staff Report

social assistance ("minimum income") program experience a withdrawal of their benefits to the same extent as they increase their work income. In addition, for individuals with child or elderly care obligations, taking up work would cause additional cost to the extent that they would then have to pay for care services.

Female workers

12. Secondary earners, i.e. mostly women, are also likely to face work disincentives. This is true in particular if it comes to the transition from part-time to full-time work. In many cases, such a transition would result in becoming subject to income taxation or moving into a higher income tax bracket.

Share of Women in Part-time Work
(Percent of Total Employed Women)

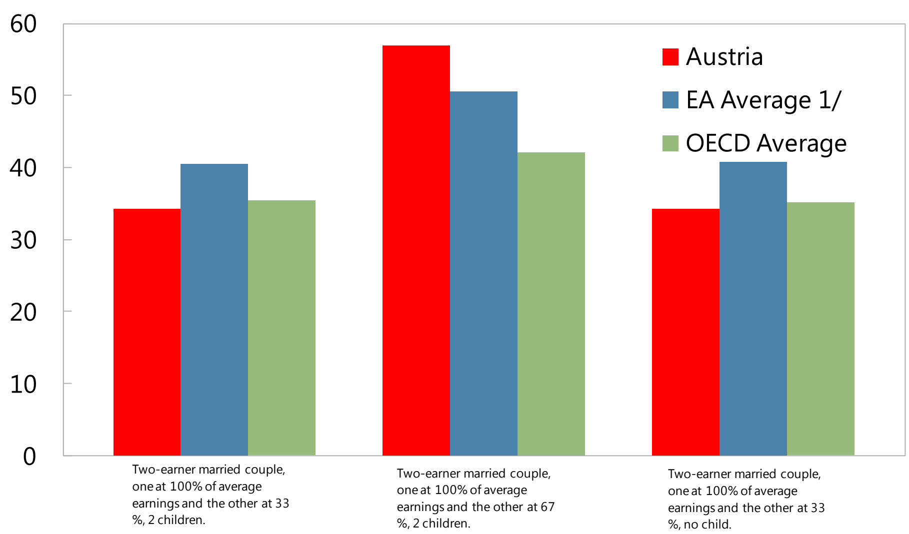


Source: Eurostat.

13. Calculations by the OECD show that the marginal tax wedge for secondary earners rises steeply in the range between one and two thirds of the average gross wage. This would correspond to a switch from part-time to full-time employment in many cases (*see text chart*). In addition, any need to pay for child care makes such a switch even less attractive financially.

14. While subsidized child care facilities are available, coverage is not dense enough. This holds especially in rural areas and for younger children below three. Also, opening hours of childcare facilities and schools (or after-school programs) are typically much shorter than a full work day, and the length of vacation periods and their distribution over the year are not in line with the needs of families with both parents working full time.

Marginal Tax Wedge (Secondary Earner) across Family Types, 2012
(Percent)



1/ Euro area average includes only OECD members.
Source: OECD.

D. Possible Solutions

15. Work incentives for low-skilled workers could be strengthened by selectively lowering social security contributions and/or payroll taxes, and reducing the entry income tax rate. In addition, benefit withdrawal when employment is taken up should be mitigated through meaningful in-work benefits. Lower social contributions, payroll and income taxes would also strengthen incentives for women to work longer hours.

16. In addition, the simplification and redesign of the family benefit system would offer women a real choice to extend their working hours. Specifically, funds could be reallocated from monetary transfers to the extension of high-quality and affordable childcare facilities, school hours, and after-school programs. In this context, monetary benefit options that encourage women to stay away from the labor market for a long time, potentially beyond the period for which their job is protected, should be abolished as they reduce the chances for full re-integration into the labor market. Monetary transfers could also be subjected to some means-testing to save budgetary resources or to in-work conditionality for both parents to further leverage work incentives.

17. Reallocation and better targeting of family benefits would help finance the proposed reforms "within the system". Beyond that, costs would need to be covered by expenditure cuts in other areas or through higher environmentally friendly or real estate taxes. [11].

[11] See for instance, Annex 4 in the 2011 IMF staff report

References

IMF (2011), Austria 2012 Article IV Consultation, IMF Country Report, 11/275, Washington

IMF (2012), Austria 2011 Article IV Consultation, IMF Country Report, 12/251, Washington

OECD (2013), Taxing Wages 2013, Paris.