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TEXT

TAGS: EFIN, PGOV, AU  
SUBJECT: TAX REFORM FURTHER STRAINS GOA COALITION

1. SUMMARY: THE TWO PARTIES IN AUSTRIA'S GOVERNING COALITION, THE SOCIALISTS (SPO) AND THE CONSERVATIVE PEOPLES PARTY (OVP), ARE GOING TO THE MAT IN NEGOTIATIONS ON THE FINAL DETAILS OF A MAJOR TAX REFORM. SPO CHANCELLOR VRANITZKY AND OVP VICE CHANCELLOR MOCK ARE PLANNING A ONE-ON-ONE MEETING THIS WEEK TO TRY TO RESOLVE THE ISSUE, WHICH HAS TAKEN ON GROWING SIGNIFICANCE IN RECENT DAYS. SHOULD A SOLUTION BE REACHED, IT WILL BE A SYMBOL THAT THE COALITION PARTIES CAN STILL GET ON WITH THE BUSINESS OF GOVERNMENT DESPITE THE EMOTIONAL CONFLICTS CAUSED BY THE WALDHEIM CONTROVERSY. FAILURE TO REACH AGREEMENT, HOWEVER, WOULD BE YET ANOTHER BURDEN THREATENING THE CONTINUED MAINTENANCE OF THE INCREASINGLY FRAGILE COALITION GOVERNMENT. END SUMMARY.

2. AUSTRIA'S COALITION PARTNERS, STILL REELING FROM THE CONTROVERSY SURROUNDING THE HISTORIANS COMMISSION REPORT ON KURT WALDHEIM, ARE STAGGERING INTO YET ANOTHER FRACTIOUS INTRA-COALITION CONFLICT. THE SUBJECT THIS TIME IS TAX REFORM.

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3. A MAJOR REFORM OF AUSTRIA'S INEFFICIENT AND CONFUSING TAX SYSTEM WAS A PROMINENT PLANK IN THE COALITION JANUARY 1987 POLICY AGREEMENT. THE PARTIES AGREED TO A REFORM BASED ON LOWER INDIVIDUAL RATES AND AN ELIMINATION OF A LARGE PORTION OF EXISTING PLETHORA OF PERSONAL EXEMPTIONS. DETAILS WERE TO BE READY BY THE END OF 1987, WITH THE NEW TAX SYSTEM ENTERING INTO FORCE ON JANUARY 1, 1989. ALTHOUGH NOT EXPLICITLY STATED IN THE COALITION AGREEMENT, IT WAS WIDELY UNDERSTOOD THAT THE REFORM WOULD BE REVENUE NEUTRAL, SO AS TO BE CONSISTENT WITH THE GOVERNMENT'S PRIMARY MACRO-ECONOMIC GOAL OF REDUCING THE FEDERAL DEFICIT.

4. THE COALITION WORKING GROUP WHICH HAD BEEN HAMMERING OUT DETAILS OF THE REFORM PRESENTED A PLAN IN THE LAST WEEK OF JANUARY WHICH MET MOST OF THE ORIGINAL OBJECTIVES. THE NUMBER OF INDIVIDUAL TAX BRACKETS WAS REDUCED FROM 11 TO 5 AND THE HIGHEST MARGINAL RATES FROM 62 TO 50 PERCENT. TAX RATES FOR ALL INCOME LEVELS WOULD BE CUT, WITH THE 50 PERCENT RATE ONLY APPLYING TO INCOMES OVER THE EQUIVALENT OF DOLLARS 58,000 PER YEAR, WHEREAS UNDER THE PRESENT SYSTEM THIS RATE APPLIES TO ANNUAL INCOME OF DOLLARS 20,000. SIMULTANEOUSLY, ENOUGH EXEMPTIONS WERE ELIMINATED TO RAISE REVENUES BY AN ESTIMATED AS 30 BILLION (DOLLARS 2.5 BILLION).

5. THERE REMAINED ONE GLARING PROBLEM WITH THE WORKING GROUP'S RECOMMENDATIONS: THE REFORM WAS NOT REVENUE NEUTRAL. AN ESTIMATED GAP OF AS 7 BILLION (DOLLARS 580 MILLION) REMAINS BETWEEN REVENUES LOST THROUGH LOWER RATES AND THOSE GAINED FROM ELIMINATING EXEMPTIONS. THE WORKING GROUP LEFT IT TO THE POLITICAL LEADERS OF THE TWO PARTIES TO IDENTIFY WAYS FOR CLOSING THAT GAP. THE ENSUING DISCUSSION RAPIDLY BOILED OVER INTO A PUBLIC CONTROVERSY AS BOTH PARTIES SCRAMBLED TO STRENGTHEN THEIR PUBLIC IMAGES BY REFUSING TO BUDGE FROM POSITIONS REGARDING NEW SOURCES OF REVENUE WHICH THEY PREVIOUSLY STAKED OUT.

6. BOTH THE SPO AND OVP LEADERS REJECTED INITIAL SUGGESTIONS FOR CLOSING THE GAP BY TAXING "13TH AND 14TH MONTH" YEAR END BONUSES AT THE REGULAR RATE. THE COALITION AGREEMENT HAD CLEARLY STATED THAT THIS INCOME WOULD CONTINUE TO RECEIVE PREFERENTIAL TREATMENT, AND NEITHER PARTY WISHED TO SET THE PRECEDENT OF RENEGING ON THE CAREFULLY CRAFTED COALITION WORK PROGRAM. THE SPO THEN REVIVED ITS IDEA OF A WITHHOLDING TAX ON INTEREST INCOME, TO RECOVER THE REVENUE CURRENTLY LOST BY THE NEAR UNIVERSAL PRACTICE HERE OF NOT REPORTING INTEREST INCOME FROM ANONYMOUS BANK ACCOUNTS (PARAS 11 AND 12 OF REFTTEL COVER THIS ISSUE IN DETAIL). SEVERAL OVP LEADERS VEHEMENTLY REJECTED THIS IDEA, LESS ON THE BASIS OF ECONOMIC ARGUMENTS THAN BECAUSE OF THEIR PREVIOUS PUBLIC COMMITMENTS TO OPPOSING THIS UNPOPULAR MEASURE. OVP GENERAL SECRETARY KUKACKA SUGGESTED AS AN ALTERNATIVE A TAX ON PRIMARY ENERGY IMPORTS, BUT IT DOES NOT APPEAR THIS ALONE COULD RAISE ENOUGH REVENUE TO CLOSE THE GAP.

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7. ALTHOUGH THERE WOULD APPEAR TO BE FERTILE GROUND FOR COMPROMISE, THE SPO HAS CONTINUED TO PUSH THE INTEREST WITHHOLDING ISSUE TO THE POINT WHERE IT HAS BECOME THE TOUCHSTONE ON WHICH THE ENTIRE REFORM WILL REST. EMBASSY CONTACTS TELL US THAT MOCK AND OTHER MEMBERS OF THE OVP, ALREADY FRUSTRATED WITH THE SOCIALISTS BECAUSE OF THEIR UNCLAS SECTION 02 OF 02 VIENNA 01817

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FAILURE TO BACK FULLY PRESIDENT WALDHEIM, MAY REFUSE TO GIVE AN INCH ON THE INTEREST WITHHOLDING ISSUE. WITH GENERAL TENSIONS BETWEEN THE COALITION PARTIES ALREADY HIGH DUE TO WALDHEIM, A FAILURE TO REACH A COMPROMISE ON THE TAX REFORM COULD BE ENOUGH TO BRING DOWN THE COALITION GOVERNMENT. ON FEBRUARY 16, OVP ECONOMICS SPEAKER TAUS TOLD REPORTERS THAT THE COALITION WOULD SPLIT IF NO AGREEMENT ON TAX REFORM WAS REACHED BY THE END OF FEBRUARY.

8. DESPITE THE CURRENT TENSION, CHANCES ARE STILL BETTER THAN 50-50 THAT SOME COMPROMISE WILL BE REACHED AND A GOVERNMENT CRISIS AVERTED. SPO FINANCE MINISTER LACINA HAS REPORTEDLY ARMED VRANITZKY WITH THREE POTENTIAL COMPROMISE SOLUTIONS, ALL BASED ON EXEMPTING HOLDERS OF SMALL PASSBOOK ACCOUNTS FROM A GENERAL INTEREST WITHHOLDING. THIS WOULD ALLOW THE OVP TO CLAIM VICTORY IN PREVENTING INTRODUCTION OF COMPREHENSIVE INTEREST WITHHOLDING, WHILE PERMITTING THE SPO TO CLAIM IT HAD PUSHED THROUGH THE WITHHOLDING IT HAS LONG CALLED FOR. THE SITUATION SHOULD BE MUCH CLEARER BY THE WEEK OF FEBRUARY 22. IN ANTICIPATION OF A CONSTRUCTIVE ONE-ON-ONE NEGOTIATING SESSION FEBRUARY 17 OR 18, VRANITZKY AND MOCK PLAN TO MEET WITH THEIR PARTY LEADERSHIP THIS WEEK OR NEXT TO REPORT RESULTS OF THEIR DISCUSSION.

9. COMMENT: TAX REFORM IS ONLY THE PROXIMATE CAUSE OF THE CURRENT GOVERNMENT TENSION. AS RECENTLY AS FEBRUARY 9, A RELAXED LACINA ASSURED THE AMBASSADOR A TAX COMPROMISE WOULD BE REACHED WITHIN TWO WEEKS. WHAT HAS CHANGED BETWEEN THEN AND NOW IS THE FEBRUARY 12 RELEASE OF THE HISTORIANS REPORT ON **KURT WALDHEIM**. THAT REPORT AND THE ENSUING CONTROVERSY HAS MOVED AUSTRIA'S DOMESTIC POLITICS FAR IN THE DIRECTION OF GREATER POLARIZATION, MAKING IT MUCH HARDER FOR THE COALITION PARTIES TO REACH AGREEMENT ON MUNDANE ISSUES SUCH AS THE LAST DETAILS OF TAX REFORM. THE TRANSITORY CRISIS OF TAX REFORM MAY, AND PROBABLY WILL, BE OVERCOME. THE UNDERLYING SHIFT IN THE DOMESTIC POLITICAL LANDSCAPE CAUSED BY THE WALDHEIM PROBLEM, HOWEVER, WILL CONTINUE TO PLAGUE THE COALITION AND HANG OVER ITS WORK LIKE A SHADOW FOR THE FORESEEABLE FUTURE. GRUNWALD

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END OF MESSAGE

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