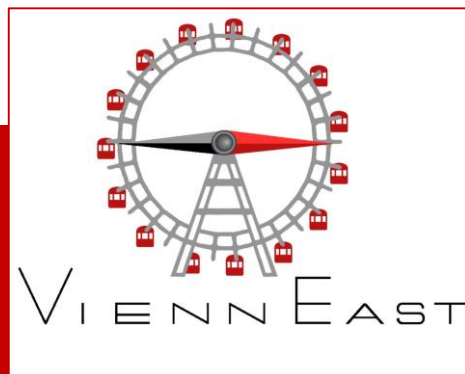


'OLD POLITICS, NEW CHALLENGES': AUSTRIA'S SHIFTING POLITICAL LANDSCAPE



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Executive Summary

The Austrian post-war political economy was founded on bipartisan compromise between the two ruling parties; namely, the conservative People's Party (*Österreichische Volkspartei: ÖVP*) and the Social Democrats (*Sozialdemokratische Partei Österreichs: SPÖ*). This arrangement was informed by a unanimous desire to avoid the partisan division that had undermined the stability of the First Republic (1919-1938) and rendered it vulnerable to totalitarian forces. As such, it necessitated the continual formation of grand coalitions through the years of reconstruction; and even when the ÖVP and SPÖ respectively governed alone in majority administrations between 1966 and 1983, consensus-based policymaking continued to prevail. Both parties became ubiquitous at all levels of society, maintaining close relationships with key institutions such as the business associations, economic chambers and trade unions. As dictated by the *Proporz* doctrine, the proportion of votes that the ÖVP and SPÖ won in elections determined bureaucratic and commercial appointments on the local, regional and federal levels.

Although post-war governance model provided the stability required to stimulate the strong economic growth that Austria experienced until the 1970s, it was also conducive to protectionism, nepotism and corruption. The electorate were prepared to tolerate this for as long as their living standards increased; however, increasingly challenging global macroeconomic conditions raised questions over the sustainability of Austria as a high-tax, tightly regulated economy. Migration flows increased and regional competition intensified as Austria's Central and Eastern European (CEE) neighbours transitioned towards market economies following the dissolution of the USSR. This provided fertile ground for the reinvention of the Freedom Party (*Freiheitliche Partei Österreichs: FPÖ*) leadership of Jörg Haider, who steered the party in a populist, far-right direction, drawing votes from across the political spectrum.

In the meantime, the old consensus between the SPÖ and the ÖVP had lost the common vision that it shared in the post-war period, and began to break down. This culminated in the controversial decision of the ÖVP to enter into coalition with the FPÖ in 2000. The compromise of government proved challenging for the FPÖ, whose vote share collapsed. The lack of alternative coalition partners, together with the looming 2008 financial crisis, prompted the SPÖ and ÖVP to resume their partnership. Indeed, the uncertainty of the international environment, combined with the increasingly fragmented political landscape, has proven to be a stabilising lowest common denominator. On the other hand, the mutual trust that previously existed between the SPÖ and ÖVP no longer exists to offset their increasingly disparate ideological stances. Necessary reforms to increase Austria's regional competitiveness have not been enacted. In the meantime, the economy is beginning to show signs of a descent into long-term stagnation, amid increasing disaffection concerning external phenomena such as the refugee crisis. Elsewhere, the FPÖ has recaptured the populist imagination.

The conclusions to be drawn from the current political landscape in Austria is that the grand coalition arrangement is no longer sustainable for as long as the SPÖ and ÖVP lack a unifying vision. Provided their increasingly fractious coalition survives until the autumn 2017 election, they will struggle to find any mathematically viable coalition partners without cooperating with the FPÖ. As such, it is very likely that Austria will shift rightward in the two-year outlook. The question is to what extent whichever party enters into coalition with the FPÖ will be able to reign in its populism and build a policy agenda that aims to improve Austrian economic competitiveness.

The bell tolls for thee ... again

The era of grand coalition politics is over. The death knell of the post-war arrangement that has informed governance in Austria has been heralded multiple times over the past two decades by domestic and international commentators. It was first heard in 2000, when the ÖVP under Wolfgang Schüssel entered into coalition with Jörg Haider and the FPÖ, abandoning its traditional partner, the SPÖ. It was heard again in 2008, when the ÖVP pulled the plug on its renewed coalition with the SPÖ after the latter revised its European policy stance along populist lines. Snap elections followed but the gambit of the ÖVP failed, with the FPÖ and other smaller parties making gains at the expense of the political mainstream. And in 2013, the death knell was heard for a third time, as the SPÖ and ÖVP – having cobbled together a coalition after the 2008 debacle – renewed their precarious partnership with a combined 50.8% of the vote, the barest of majorities.

Given how often time has been called on the post-war status quo, it's reasonable to raise an eyebrow at the alarmism of the media. Austria isn't a country that embraces change with open arms, which the former chancellor, Alfred Gusenbauer (2007-08), explained as naturally expressing "the subconscious feeling that people are content with things as they are"ⁱ. The informal structures of the Second Republic, combined with its small size and location within Europe, has rendered its politicians and electorate pragmatic to the point of pathology. As Caroline de Gruyter, the NRC Handelsblad's correspondent for European Affairs, put it: "Muddling through is second nature to [the Austrian]"ⁱⁱ. Indeed, although partisan division has not been uncommon in Austria since 1919, ideology itself has seldom dictated its politics.

This is changing. Global economic trends, combined with confused policy shifts by both the SPÖ and ÖVP in an attempt to recapture drifting voters, have undoubtedly undermined political stability since 2000. In turn, the fabric of the post-war consensus is gradually wearing away. The question is whether this is a good thing or not.

Everybody (in the establishment) wins

The guiding principle of Austrian political culture since 1945 has been consensus and compromise. This was novel for a country whose infant years prior to the *Anschluss* were characterised by bitter infighting between the predecessor parties of the SPÖ and ÖVP. The political landscape was paramilitarised for much of the period, with both parties sanctioning the formation of affiliated militias. In 1933, the Catholic-conservative predecessor of the ÖVP, under the charismatic leadership of Chancellor Engelbert Dollfuss, suspended parliament and established the Corporate State (*Ständestaat*). A brief but bloody civil war ensued in the following year, with the Socialists taking an uncoordinated and desperate stand that led to their abolition alongside the Nazis and all other political parties and organisations.

The dismantlement of democracy sealed the fate of the First Republic. In 1936, the *Ständestaat* – which had seen Dollfuss killed during a failed Nazi coup in 1934 – attempted to assuage an increasingly expansionist Third Reich by admitting Austrian Nazis into the cabinet, thereby granting the party legitimacy. This backfired: Austria was laid open to German annexation, and by the time the *Ständestaat* attempted to build bridges with its former pro-democratic foes in order to shore up its support, it was too late.

The bullheaded politicking of the interwar period was the basis for the new bipartisan model of governance that emerged just seven years after the *Anschluss*. The electorate associated the dysfunction of the First Republic with the slide towards totalitarianism; which, consequently, had led to total war and the communist threat. After the various allied forces occupied Austria in 1945, the USSR claimed ownership of the east of the country, where the majority of economic activity was concentrated. Vienna was subdivided into four zones, much like Berlin. But the SPÖ and ÖVP were determined to avoid the fate of their neighbouring states. Amid tenacious haggling by the British and Americans to secure Austrian

sovereignty, Karl Renner – who had served as the first chancellor of the First Republic – quietly insisted to the Soviets on the need for free elections. The Soviets, confident that the Austrian Communist Party (*Kommunistische Partei Österreichs*: KPÖ) would win an absolute majority, conceded, only to see the SPÖ and ÖVP form a grand coalition, thereby locking out the KPÖ – soundly defeated in any event – from government.

Consensus between the two erstwhile archly opposed political parties was thus necessary to safeguard the democratic legitimacy that had been won in the 1945 election; and it was partly their partnership that helped Austria avoid becoming another Soviet satellite, the only sovereign state that had been occupied by the USSR to do so. Key economic sectors were nationalised in order to prevent the Soviets from gaining leverage through expropriations of private assets. Full independence was enshrined in 1955, when the Second Republic was inaugurated with a State Treaty and constitution.

The bipartisan model of governance that flourished during the years of occupation, and became the *modus operandi* thereafter, was two-pronged, consisting of the *Proporz* doctrine and a German-style social partnership. The former hinged on political patronage, with bureaucratic and even key commercial appointments being based on party affiliation according to the proportion of votes won in each election. This extended beyond the federal level, given that the provinces had their own administrations, which tended to be based on absolute majorities rather than grand coalitions. Meanwhile, the social partnership invited key corporate actors – namely, the trade unions, economic chambers, business associations and other civil society organisations – to assume contributory roles in the policymaking process.

The restructuring of the governance system fostered a political stability that contributed to the *Wirtschaftswunder* enjoyed by Austria through the 1950s and 1960s. The arrangement was such that even when the ÖVP and SPÖ were respectively able to govern without the support of the other in 1966-70 and 1970-

86, bipartisan consensus remained integral to the system. This was due to the ability of either party to fortify their regional strongholds by pumping apparatchiks into public posts on the provincial level regardless of their strength in the federal arena. Indeed, although the provincial governments are without many nominal powers, they – and their governors, in particular – are able to act as decisive brokers between social actors, and can influence administration even in policy areas where they lack direct control. As such, even during the periods of single-party governance, neither the ÖVP nor the SPÖ took a backseat. For example, in the 1983-86 period, 80% of legislation that passed through parliament received unanimous approvalⁱⁱⁱ.

Chicken or the egg: Economics before politics?

The bipartisan governance model – particularly the *Proporz* system – became increasingly unpopular during its golden era. It may have guaranteed stability but its cosiness was quickly associated with shady backroom deals, nepotism and corruption. The ubiquity of the two parties at most levels of society also allowed them to gain leverage over citizens in exchange for their vote. For example, the SPÖ, which presided over large-scale social housing projects in many cities, effectively awarded apartments on the basis of whether the prospective beneficiaries had voted for the party or not.

The way in which the two parties cemented their influence greatly inhibited the emergence of any alternative political parties, since they automatically entered the policymaking arena as outsiders. However, the electorate were prepared to begrudgingly tolerate *Proporz* so long as economic growth continued and their living standards increased. The 1970s witnessed especially sharp appreciations in the latter category as Chancellor Bruno Kreisky (1970-1983) – a Jewish returnee otherwise known as the “Sun King” – and his SPÖ government pumped money into public services and pushed through a large number of social reforms.

This began to change in the 1980s, not long after Kreisky stepped down. The FPÖ – which had begun its life as a rump party of former moderate Nazis who embraced economic liberalism and twice propped up SPÖ governments – increased its popularity from rock bottom levels under the capricious leadership of Jörg Haider, who steered the party in the direction of populist nationalism. Although regarded as a far-right figure, Haider was an early pioneer of the anti-establishment politics that became so familiar in the post-2008 climate, transcending the partisan divide to capture voters who were threatened with disenfranchisement as a result of creeping globalisation. Both the SPÖ and ÖVP began losing voters to Haider and the FPÖ, who managed by 1990 to more than triple their vote share from a low of 5% in 1983.

With their political monopoly threatened, the SPÖ and ÖVP closed ranks, and in the absence of absolute majorities defaulted to the grand coalition arrangement. This was very much a practical arrangement. Their cooperation lacked the same unifying vision that had been shared in the post-war period, even though the disintegration of the USSR was creating new opportunities in Austria's former imperial heartlands. By 1999, their arrangement broke down, having become increasingly acrimonious. This was partly due to the loss of the mutual trust that they had built up in the post-war years through the social partnership. The stealthy and sudden acquisition of Creditanstalt – a historic bank with close links to the ÖVP – by the SPÖ-affiliated Bank Austria in 1995 was a key turning point in this respect.

But there were deeper reasons for the decline of grand coalition politics than the mere erosion of mutual trust. Global macroeconomic trends had increasingly challenged the post-war political economy. The 'stagflationary' crises of the 1970s – culminating with the effective dismantlement of the Bretton Woods system in 1971 – upended the Keynesian paradigm in many states. Governments elsewhere began enacting reforms that emphasised deregulation, liberalisation and privatisation, policies that were crystallised in the process that guided the integration of the European Union, of which Austria became a member in 1995.

The “Austro-Keynesian” economic paradigm that informed governance in the post-war years had taken for granted the desirability of deficit spending, full employment, state ownership, welfare provision, as well as the social partnership and *Proporz* system. But these assumptions slowly broke down as the SPÖ and ÖVP grew further apart ideologically, even as both embraced the European project. Similarly, the ability of Austria to remain a high-tax, tightly regulated economy whilst attracting the business of multinationals has come into question in more recent years, as its CEE neighbours – particularly Poland, the Czech Republic and Slovakia – become increasingly competitive.

Differences over such questions, combined with the erosion of mutual trust, are what ultimately drove the ÖVP to abandon the SPÖ for the FPÖ in 2000. Indeed, Wolfgang Schüssel saw an historic opportunity to dismantle the economic hegemon that the SPÖ had cultivated since 1970, and found the FPÖ to be a willing partner in crime. It was a controversial arrangement; besides the fact that the ÖVP tied with the FPÖ as the second largest party with 26.9% of the vote each, the willingness of Schüssel and his colleagues to elevate a far-right party into power saw Austria condemned internationally, and numerous EU member states temporarily severing diplomatic relations.

The lowest common denominator

The “black-blue” coalition did not blaze the trail of xenophobic destruction that many feared. Its mandate was largely confined to an agenda of economic liberalisation. Elsewhere, Schüssel was careful to neutralise anxieties over his partnership with the FPÖ; namely, by keeping Haider away from federal office. This panacea proved to be highly destructive for the FPÖ, blunting its radical edge, while Haider openly criticised the coalition from his stronghold in Carinthia, where he was governor. In 2005, the party split and its vote share collapsed.

By 2007, after prolonged negotiations, the two parties resumed their partnership, although its viability was questionable from the outset. After less than two years, the ÖVP collapsed the coalition in an attempt to force new elections after Alfred Gusenbauer – and his protégé, the incumbent chancellor, Werner Faymann – proposed holding a referendum in the event of further changes to the EU treaties.

The gambit failed: both parties scored historically low results, while the FPÖ and Jörg Haider’s newly formed Alliance for the Future of Austria (*Bündnis Zukunft Österreich*: BZÖ) posted solid gains. By this point, the 2008/09 financial crisis had struck, hammering the balance sheets of the Austrian banks exposed to toxic loans (especially those denominated in foreign currency) in CEE and the Balkans, especially Hungary, Romania and Serbia. Three mid-sized banks received bailouts, while even the systemic institutions of Raiffeisen, Erste and Bank Austria required assistance. In this climate, the need for stability again became the lowest common denominator between both parties, and grand coalition provided the safest port during the storm.

A remarriage of inconvenience

The principle of the lowest common denominator provided the *raison d’être* of the first Faymann government. But even this ceased to be the case as the two parties proceeded to sleepwalk through the 2013 elections, even as the electorate began to explore an increasingly colourful and fragmented political landscape. Despite Haider’s defection (and subsequent death in a car crash in 2008), the FPÖ continued their resurgent ascent and have maintained this momentum ever since in the polls. Smaller parties, such as the left-liberal Greens (*Die Grünen – die Grüne Alternative*), the radical centrist New Austria (*Das Neue Österreich*: NEOS) and right-wing eurosceptic Team Stronach, similarly threatened the SPÖ and ÖVP, pulling their erstwhile supporters in a variety of ideological directions and their respective vote shares to historic lows.

Nevertheless, despite some idle threats by the ÖVP to form a three-way government with the FPÖ and Team Stronach, grand coalition held. But within months, it began to waver. There was a realisation, particularly on the part of the ÖVP, that both parties were so opposed on policy that neither could deliver legislation of any substance. The SPÖ, despite having embraced “third way” thinking to some extent, remains one of the most left-wing mainstream parties in Europe, championing golden state shares and investment, and advocating increased taxation of property, wealth, millionaires and banks. The ÖVP, on the other hand, push for full privatisations, liberalised labour markets, tax cuts and spending restraint, placing it further to the right of many of its sister parties elsewhere on the continent. Such diametric opposition can only be a recipe for paralysis.

The governance programme that was agreed combined half-hearted austerity measures, a vague commitment to tax reform and possible partial privatisations, and some welfare concessions, all of which added up to a diluted policy cocktail that was clearly never going to excite a disgruntled electorate. Before long, partisan disputes broke out in the public view as frustrated ministers and party officials began openly briefing against each other. President Heinz Fischer – a respected veteran SPÖ functionary – rushed to host crisis talks. In the meantime, the FPÖ was increasing its poll ratings without even needing to devise concrete policy.

The rising threat of the FPÖ has been the main factor in keeping the coalition from collapsing. Both parties are aware that calling snap elections would only lead to further losses to the FPÖ such that if either party entered into a coalition with the FPÖ, they would risk being the junior partner. Moreover, despite some vague interest within the ÖVP to govern with the FPÖ, there are some red lines that have emerged since 2000, most notably European policy. Such red lines are likely to form a greater obstacle than in 2000 since the FPÖ are wary of compromising on their populist agenda, remembering the ten-year setback inflicted by the previous black-blue coalition, and looking to the faltering approval ratings of sister parties elsewhere.

As such, the ÖVP initially made an effort to reach out to the SPÖ in August 2014, forcing its leader, Finance Minister Michael Spindelegger, to resign. Spindelegger, who had overseen a lacklustre electoral performance, had insisted on prioritising fiscal consolidation, whereas the party largely wanted to buoy its popularity with tax cuts, giving impetus to the putsch. Spindelegger was replaced as vice chancellor by Economy Minister Reinhold Mitterlehner, who hails from the liberal wing of the party, and as finance minister by a technocrat, Hans Jörg Schelling.

The reshuffle breathed new life into the coalition for six months, while the tax package was negotiated. Although partisan differences remained – the ÖVP and its affiliated social actors were unprepared to significantly increase taxes on millionaires and property, for example – common ground was found on the desirability of cutting the income tax burden, which was the second highest in the EU. Once the package was agreed, the parties hailed it as the “biggest tax reform of all time”^{iv} despite their awareness that it was another muddled compromise that had only served to buy their cohabitation some more time.

However, the durability of the coalition is continually being threatened by every new policy question that arises. The refugee influx from the Middle East and North Africa that began to accelerate in 2015 was a major challenge, with the SPÖ initially blocking ÖVP proposals to impose an annual quota on those being admitted for either asylum in or transit through the country before conceding to minimise future electoral losses. Indeed, the scale of the potential losses to the SPÖ and ÖVP was demonstrated by successive state elections in 2015, including in their respective regional strongholds of Vienna and Upper Austria, where the FPÖ sharply increased its share of the vote. The SPÖ and ÖVP candidates in the presidential election in April 2016 – both of whom are apparatchiks – are similarly likely to perform poorly, further reflecting their waning ability to capture the popular vote.

Only a matter of time

Although the end of the era of grand coalition politics has been heralded repeatedly since the 1999 election, it has been a dysfunctional means of policymaking since the ascendance of the FPÖ in the 1980s. The question is how long the lowest common denominators that have united the SPÖ and ÖVP will continue to hold. There are reasons to believe that it will not be much longer.

The Austrian economy, long a jewel in the European crown, combining the productivity of a specialised *Mittelstand* with a generous welfare state, is slowing down. According to the European Commission, gross domestic product (GDP) grew by a mere 0.4% in 2014 and a further 0.7% in 2015, below a Eurozone average of 1.5% and Germany's projected 1.9%^v. In 2011, Austria had a 4% unemployment rate, the lowest in the EU^{vi}. By January 2016, it stood at 5.8%, thereby falling to fifth place in EU rankings^{vii}. It is unclear whether these trends will be a lasting phenomenon; and even then, the state remains one of the wealthiest in the EU, prompting the thought that its travails are alarmism.

But such assured complacency has informed economic policymaking for the past decade – perhaps longer – but particularly under the Faymann government. Indeed, Austria could be headed towards a longer-term stagnation, not unlike France. Domestic demand is weak; while states such as Poland and the Czech Republic are taking increasingly large bites out of the German import market, typically a stable source of income for Austrian companies. Investment is similarly waning, as Slovakia, the Czech Republic and Hungary draw foreign capital to strategic sectors such as automotive parts manufacturing despite institutional uncertainties.

The exposed Austrian flank is not only about its relatively high tax and regulatory burden. This economic structure had existed in the past and was not a major impediment. More pressing is the education system, which again, having once been a European leader, has sharply deteriorated in quality, producing far more unskilled

workers than the market demands. Indeed, one-fifth of school leavers do so without having obtained verifiable skills in either reading or arithmetic^{viii}.

Predictably, how to deal with these issues forms a bone of ideological contention between the SPÖ and ÖVP; but they are becoming increasingly urgent and will require radical action to address. And yet, although no such solution is foreseeable, the political uncertainty of divorce is such that neither party has been willing to take the plunge.

Regardless of whether the grand coalition survives until the federal election in autumn 2017, a system that has come to be characterised by governments that are paralysed by omnipresent threats to their continuing existence is not sustainable in the long-term. The SPÖ and ÖVP will need to venture out of their unhappy cohabitation and deal with other parties – including, most likely, the FPÖ – in order to devise the fresh and distinct policy programmes that could help in strengthening their electoral standing and improving economic competitiveness. If they fail in this, and choose instead to prioritise their own vested interests, the electorate will very likely dismantle the grand coalition as a means of governance altogether.

In this scenario, it is highly likely that the FPÖ will be the beneficiary. The electoral system, which is based on proportional representation, would not furnish the FPÖ with an absolute majority, thereby necessitating its cooperation with either the SPÖ or ÖVP. It is not clear that the FPÖ would pioneer any of the reforms necessary to increasing Austrian economic competitiveness, given that its policy platform primarily prioritises consumer-oriented tax cuts and a sharp reduction in immigration levels. Such a scenario would likely ensure that Austrian competitiveness continues to stagnate, potentially causing significant economic damage until a new political partnership emerges.

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- ⁱ http://diepresse.com/home/politik/eu/349184/Gusenbauer_Die-osterreichische-Seele-ist-sehr-komplex
- ⁱⁱ <http://carnegieeurope.eu/2014/11/05/austrian-acrobatics-in-europe>
- ⁱⁱⁱ Mair & Smith, *Understanding Party System Change in Western Europe*, P11
- ^{iv} <http://www.oe24.at/oesterreich/politik/Das-bringt-die-groesste-Steuerreform-aller-Zeiten/180399455>
- ^v http://ec.europa.eu/economy_finance/eu/countries/austria_en.html
- ^{vi} <http://diepresse.com/home/wirtschaft/international/721797/Osterreich-hat-geringste-Arbeitslosigkeit-in-EU-?from=simarchiv>
- ^{vii} <http://derstandard.at/2000030145081/Osterreich-Arbeitslosigkeit-naehert-sich-500-000er-Marke>
- ^{viii} <http://derstandard.at/1375625742402/Ein-Fuenftel-nach-Schulpflicht-ohne-Zeugnis>