

RECOMMENDATIONS BY THE FISCAL ADVISORY COUNCIL ON AUSTRIA'S BUDGET POLICY FOR 2025

Background:

- The current budget situation necessitates large structural consolidation efforts to
 - recover fiscal space;
 - make it possible to realize the new federal government's political agenda;
 - open up the room for maneuver needed for necessary future investments;
 - create long-term debt sustainability; and to
 - achieve compliance with the EU's fiscal rules, which implies large consolidation needs at the very beginning of the adjustment period.
- On November 26, the European Commission presented a report under Article 126(3) of the Treaty on the Functioning of the European Union. In this report, the Commission stated that Austria's deficit path will lead to the opening of an excessive deficit procedure (EDP) for Austria. At the same time, the Commission stated that it might consider refraining from proposing the opening of an EDP at the ECOFIN (meeting of January 21, 2025). For this to happen, Austria would have to present a clear and credible concept until mid-January 2025; such a concept would need to outline how it plans to reduce the deficit to a maximum of 3.0% of GDP in 2025.
- If an excessive deficit procedure were to be opened against Austria, this would significantly reduce the consolidation need over the next years under EU rules. Currently, the need for corrective fiscal measures must be brought into line with the need for measures that will stimulate the weak economy or that could strengthen Austria's competitiveness as a business location.

Austrian budget needs consolidation without taboos – and: negative cyclical feedback effects need to be kept at a minimum

Recommendations:

- Given the large need for consolidation, corrective measures will need to be comprehensive and, realistically, will need to include both expenditure and revenue measures. Empirical analyses indicate that expenditure-related consolidation measures have a more sustainable budgetary impact (Aiginger et al., 2010).¹ In any case, the new government needs to agree on a balanced holistic concept for a consolidation path that should cover the entire legislative session. We use the term "balanced" so as to denote a mix of measures that vary in scope, speed and duration and in terms of which groups of the population they affect (distributional effects); their application will need to be staggered over the entire adjustment period.
- When deciding on a combination of measures, the government needs to consider macroeconomic feedback effects to avoid a further deterioration in the already weak economy; it also needs to avoid a situation in which the effects of automatic stabilizers cause a "consolidation spiral" that conflicts with the overall consolidation strategy. Against this background, the government should also consider measures with a stimulating effect on the economy and the labor market. Moreover, any consolidation package needs to take into account how long it takes to prepare and implement certain measures, and for their fiscal effects to fully unfold; also, the volume and sustainability of the fiscal effect needs to be considered.
- For each measure, the government will need to decide if it will be of a permanent or temporary

¹ Aiginger, K., H. Pitlik and M. Schratzenstaller (2010). Optionen zur Konsolidierung der öffentlichen Haushalte in Österreich. *Ausgangslage und Erfolgsbedingungen*. WIFO-Monatsberichte 83 (3). 219–232.

nature and if the expense or revenue position in question is to be completely phased out or changed in amount and/or changed in terms of growth dynamics. Temporary measures with short-term effect, for instance, may help to bridge the period until medium- to long-term structural reforms can fully show effects.

- Against this background, there will need to be talks and decisions on numerous issues. Ultimately, these talks and decisions need to produce a mix of measures that ensures that the burden of consolidation is divided evenly among different groups of the population.
- To achieve such a mix of measures, all involved parties will need to demonstrate a fundamental openness to dialogue and compromise. They may need to abandon their traditionally unshakable positions on some topics that have thus far been avoided – even in areas that were presented as dealbreakers for government participation prior to the parliamentary elections. Against this background, a broad range of issues must be included in political negotiations in an open-minded fashion.

Quick consolidation fixes need to be accompanied by structural reforms from the onset to ensure that there are no gaps between short-term and longer-term consolidation effects

Recommendations:

- The government needs to: raise the efficiency of financing and spending arrangements across all levels of government in Austria, in particular by front-loading a reform of task sharing, which is a prerequisite for an effective implementation of principles of public finance; this includes aligning government tasks with the power to tax and the power to spend, promoting a more task-based allocation of funding and tax autonomy when it comes to financing tasks, as well as disentangling and reducing financing flows across the different levels of government;
- press ahead with structural reforms in areas with responsibilities across different levels of government to unlock efficiency potential (in particular, education, health care, long-term care);
- further increase the effective retirement age through targeted measures aimed at keeping people in employment longer and implement measures to maximize the employment potential;
- refrain from ad hoc legal interventions in the pension system that drive up expenditure so as to safeguard the system's sustainability and, as a consequence, the sustainability of public finances;
- improve coordination between central, regional and local authorities to put together adequate needs assessments and development plans for long-term care services and to ensure consistent service performance and quality standards; an increase in expenditure is unavoidable, therefore a model for orderly and sustainable funding is needed;
- enhance the Austrian health system with the aim of establishing integrated health care services with better coordination in needs assessment, process planning, steering and funding.

Investing in the future and providing for future crises requires fiscal space

Recommendations:

- Core components of current and medium-term fiscal policy need to be: creating fiscal space for investments in the future, minimizing budget risks and making provisions for necessary transition processes. This means that the necessary consolidation strategy needs to go beyond the requirements of a strictly rules-based fiscal policy.
- All levels of government need to adopt a strategic, coordinated approach, in particular to tackle the following challenges:

- strengthening Austria's competitiveness, especially through a comprehensive digitalization campaign; speeding up the expansion of renewable energies and energy infrastructure; mobilizing labor supply and creating measures that give all groups within the population access to high-quality education and to additional qualifications;²
- supporting the green transition and ensuring environmental protection that is coordinated across all levels of government;
- lack of skilled labor, mostly caused by demographics, skills mismatch and the specific economic requirements caused by digital and green transition (twin transition);
- education, including early childhood care and education;
- increasing efficiency in the dynamic expenditure categories of health and long-term care.

Compliance with EU fiscal rules is essential to regain long-term debt sustainability

Recommendations:

- Compliance with the EU fiscal rules is important to ensure the long-term sustainability of public finances. What is more, complying with these rules is an obligation under EU law that must be met by all member states, including Austria.
- Austria needs to use its contribution to stability to maintain its image as a strong and reliable partner in and for Europe. This is essential if it wants to take an active part in shaping policy in Europe in Austria's interest.
- Austria needs to use its negotiation potential vis-à-vis the European Commission to make the most of the available leeway in determining country-specific adjustment paths in national fiscal and structural plans. This can be important for e.g. negotiating the timing of necessary corrective measures taking into account the current economic situation, or the recognition of consolidation measures.
- Moreover, any flexibility and room for negotiation available under the fiscal rules should be used to spread the large volume of necessary corrective measures across the entire adjustment period in a way that also reflects the needs of the economic cycle.

In-depth evaluation of subsidization needed to raise efficiency and tap into potential for cost reduction

Recommendations:

- The government needs to: adopt a holistic strategy on reforming subsidization in Austria that needs to focus on minimizing target conflicts, redundant parallel structures and dead-weight effects; such a strategy also needs to focus on raising transparency and ensuring that public support goes where it is really needed; this also includes better coordination within and across different levels of government, which involves the subsidizing bodies and the institutions they sometimes use to outsource the administration of subsidies;
- carry out a systematic scrutiny and evaluation of all subsidies that looks at: defined target and target realization, funding used, and alternative policy measures that might be suited to reach the defined target more efficiently and cheaply; just like subsidies, alternative instruments (e.g. regulatory measures) need to be chosen in a fashion that takes into account their effectiveness and cost

² For more information, see Productivity Board (2024).

efficiency, as well as associated bureaucratic and administrative cost;

- support the creation a database that captures household incomes; this is important to make sure that future measures are more targeted, and will reduce budget costs;

Budget policy needs to be aligned with principles that ensure sustainable government finances

Recommendations:

- To ensure long-term debt sustainability in Austria, the consolidation process must be guided by the following principles of budget policy³:
 - measures for short-term consolidation must be accompanied by structural measures with medium-term effect;
 - consolidation measures should not frustrate the intended effect of economic measures and, hence, need to be embedded in a comprehensive fiscal policy strategy;
 - consolidation measures must ensure a balanced distribution of the associated burden among different groups of the population, guided by equality considerations; active communication about necessary consolidation measures, targets and plans for reaching targets is essential to minimize frictions during the implementation phase;
 - consolidation requires attention to the structure of revenue increases (generating “twin dividends”) and expenditure cuts (avoiding across-the-board cuts); sustainable consolidation is more likely on the expenditure side;
 - strict budget execution over several years supports adherence to a chosen consolidation path;
 - parliamentary processes (periods for submitting comments, draft legislation and legislative initiatives with regulatory impact assessment) need to be completed without shortcuts;
 - new measures may only be introduced if they are accompanied by specific funding;
 - the costs of inaction (e.g. potentially necessary purchases of emission certificates, penalty payments, longer-term follow-up costs) should always be considered;
 - a suitable data basis and design of measures etc. must ensure that measures are truly targeted;
 - additional expenditure on public administration is only warranted if expenditure in the same specific area was previously scrutinized for cost-cutting potential;
 - stop-and-go policies need to be avoided; announced measures need to have strong credibility to ensure planning certainty and continuity in implementation for the target groups of economic policy;

lawmakers need to avoid additional complexity in legal frameworks to minimize bureaucracy and admin for the public administration apparatus and the target groups of the measures.

³ The outlined principles are in part based on Balasundharam et al. (IMF Working Paper, 2023) and Aiginger and Schratzenstaller (2011).