FISKALRAT
Austrian Fiscal Advisory Council

FISCAL RULES COMPLIANCE REPORT 2017–2022 (MAY 2018) – SUMMARY

The "**Fiscal rules compliance report for 2017 to 2022**" analyzes the Austrian government's medium-term budget performance, provides information about Austria's compliance with EU-wide fiscal rules and highlights critical aspects of the national fiscal framework. The analysis builds on the Fiscal Advisory Council's own budget forecast for the years 2018 and 2019.

Good economic conditions help fiscal consolidation – Austria expected to be in compliance with EU fiscal rules in 2018 and 2019

The Fiscal Advisory Council sees a **positive outlook** for the Austrian economy but assumes that the **upswing peaked** at the end of the first quarter of 2018. Annual real GDP growth is expected to climb further – to more than 3% – in 2018, after 2.9% in 2017 (2016: 1.5%), and to slow down somewhat thereafter (2019: 2.2%; source: WIFO).

The **general government deficit ratio**[1] dropped to 0.7% of GDP in **2017** (as forecast by the Fiscal Advisory Council in the fall of 2017), following 1.6% of GDP in 2016; this reduction was slightly more pronounced than originally expected (the Federal Ministry of Finance's budget plan of October 2017 envisaged a general government deficit ratio of 0.9% of GDP). According to the Fiscal Advisory Council's latest calculations, **Austria was in compliance with all EU fiscal rules in 2017.**

According to the government's **current budget program**, Austria will remain broadly in **compliance with the EU-wide multidimensional budget rules** (deficit rule, structural fiscal rules, debt rule) over the entire forecast horizon from **2018 to 2022**. Current estimates predict that Austria will fail to comply only with the **expenditure rule**, but the deviation is not likely to be "significant." Overall, it is **not expected** that the **European Commission** will address an "**early warning**" to Austria. Some Member States and some members of the European Commission consider the **expenditure rule** to be preferable to the structural deficit rule as a benchmark for assessing a Member State's current fiscal path. For Austria, experience has shown that this rule involves **greater estimation uncertainty** and is more difficult to comply with.

The new government's **medium-term general government budget program** (in terms of ESA 2010) laid down in March 2018 (the federal government's 2017–2022 stability program) is aimed at **making use of the currently good economic conditions and avoiding procyclical measures and new debt from 2019 on**. According to the program, the general government (Maastricht) balance is expected to reach zero in 2019 (2018: –0.4% of GDP) and to turn slightly positive in the subsequent years (2022: +0.4% of GDP). At the same time, the government aims at gradually reducing the **tax-to-GDP ratio toward 40%** (2017: 42%).

Austria's **structural budget deficit** adjusted for cyclical and one-off effects is expected to **deteriorate in 2018** according to the **Fiscal Advisory Council's current forecast**. Even though some fiscal spending measures have been renounced, the structural budget deficit will reach 0.7% of GDP (2017: –0.5% of GDP). In **2019**, the **structural budget deficit is expected to improve to 0.4% of GDP**. If the unusual events provisions (additional costs originating from refugee migration and counter-terrorism measures) or the normal margin of tolerance of 0.25 percentage point are taken into account, Austria will be **in**

1 Central, regional and local governments and social security funds as defined in the European System of Accounts (ESA 2010).

compliance with the EU's structural budget rules both in 2018 and 2019, current estimates suggest (structural general government deficit including unusual event provisions: –0.4% of GDP in 2018 and –0.3% of GDP in 2019). The current government's fiscal consolidation efforts helped avert a breach of the structural budget rule in 2018 that the Fiscal Advisory Council had predicted in fall 2017.

The **government** expects a **general government (Maastricht) deficit of 0.4% of GDP for 2018**, which would be 0.4 percentage point below the budget estimate of fall 2017. The measures adopted with the **2018/2019 twin budget** point to a gradual departure from the previous expansionary fiscal path. The deficit reduction was mainly achieved by **scaling down discretionary measures with procyclical effects** (e.g. prematurely terminating the "employment bonus" program, which had been targeted at providing employers' with hiring incentives, and decreasing the investment subsidies for SMEs and large businesses) and again **extending the time horizon for additional infrastructure investments**.

According to the **Fiscal Advisory Council's current forecast,** Austria's **deficit will drop** to 0.2% of GDP in **2018**. This means that – based on the planned or already adopted budget measures the Fiscal Advisory Council is currently aware of – **a small budget surplus** of 0.1% of GDP already seems possible for **2019**. The **improvement in the budget situation** is mainly driven by persistently **lively economic growth** that means high government revenues through taxes and social security contributions; on the expenditure side, the improved labor market situation and the **decline** in **interest payments** on government debt have helped rein in spending (Fiscal Advisory Council estimate: EUR –0.9 billion).

The **Fiscal Advisory Council welcomes the government's fiscal efforts during this boom phase, in particular the reduction of discretionary measures** with **procyclical effects**. It recommends **countercyclical fiscal policies** aimed at achieving budget surpluses in economically good times (positive output gap) and budget overspending in economically bad times (negative output gap). In perfect agreement, international organizations like the European Commission, OECD and IMF, demand that economically good times be used for structural reforms and fiscal consolidation.

Different levels of government need adequate division of responsibilities and financing structures to ensure a sustainable fiscal course

If the federal government wants to **stay on track** with its **medium-term fiscal path**, according to which there will be no new debt at the general government level from 2019, it will need to tackle several **reform issues**:

- **Improving the fiscal laws applicable to central, regional and local government authorities:** In the Fiscal Advisory Council's opinion, **new laws with significant** economic and financial **effects for Austria** should only be adopted **on the basis of impact assessments** with **high quality standards** that aim at strengthening a strategic medium-term fiscal path. This would prevent unexpected budget effects or ad hoc measures (in particular in the run-up to elections). **International organizations** (OECD and IMF) are likely to provide input on improving the **quality of such impact assessments** in the context of their **evaluation of the Federal Budget Reform**, which should be published. This project should also involve an evaluation of the **value-added and employment multipliers** applied to impact assessment calculations.

- Achieving a **sustainable financing system and limiting the increase in costs** for **long-term care**: Staying within the limits defined in the 2017–2021 fiscal sharing agreement, i.e. a maximum of +4.6% per annum, could prove difficult because **recourse to patients' assets** is no longer an option (parliamentary decision of end-June 2017). A study conducted by the Office of the Fiscal Advisory

Council, (Grossmann and Schuster, 2018) shows that, even without this parliamentary measure, cost increases for long-term care can be expected to amount to an average of 4.4% to 6.3% per annum between 2016 and 2030 (depending on the scenario). Based on subsectoral estimates, the fact that the option of recourse to patients' assets has been abolished will cause additional net costs of up to EUR 650 million each year (Austrian Association of Cities and Towns and KDZ[2], 2018). On May 18, 2018, the federal government and the regional governments agreed that the federal government would reimburse the regional governments for their additional care costs up to 340 million in 2018.

- **More harmonization and transparency in the area of social services and subsidies**: The government's plans include **uniform means-tested minimum benefits across Austria** that are intended to ensure that **the basic needs of eligible recipients** can be met – among other things with more social benefits in kind – and, at the same time, to increase **incentives for taking up work**. In poverty-related matters, the **federal government is responsible for framework legislation** and can define overall standards for effectively fighting poverty. In the context of **subsidies**, the **transparency database** should be finalized and used to achieve **better coordination** between the different levels of government; also, information stemming from the transparency database should be made accessible to the public – subject to the applicable data protection rules – and summarized in regular reports.

- **Identifying efficiency potentials in social security funds and raising the actual retirement age**: In this context, the federal government's 2018/2019 twin budget laid down a rise in the eligibility age for **phased retirement** by one year from 2019. Specific **reform steps** regarding untapped efficiency potentials in **social security funds**, in many areas, have yet to be defined and implemented. As the **Pension Sustainability Committee** has been dissolved, there is a lack of **current information** on the outlook for pension expenditure in Austria. The **Fiscal Advisory Council advocates the compilation and publication of annual expert opinions** on **all government pension systems**.

- Decisively pursuing a **reform of government/federalism** with a view to **untangling competencies and financing flows** within the different levels of government, especially in the area of **health, child and long-term care** and **strengthening school autonomy** in the **education sector**. In this context, the 2017 school autonomy package should be given greater consideration.

- Preparing a **structural tax reform** that provides an easing of the tax burden on income without jeopardizing fiscal stability, as well as strongly prioritizing measures against **social security and tax fraud** at national and international level.

- **Stepping up investment in the integration** of **persons that have been granted asylum status** and ensuring that **invested funds are used effectively**: **Measures** directed at **quick integration** (e.g. integration campaigns and training, facilitated labor market access, uniform standards for means-tested minimum benefits across Austria) may slightly raise government expenditure in the short term, but should minimize related government costs in the long run.

All in all, the Fiscal Advisory Council supports the **moderate consolidation path** the federal government plans to realize mainly on the back of efficiency-enhancing reforms as well as initiatives directed at a **sustainable increase in potential growth** and **employment** (e.g. reducing the tax burden on labor, promoting public infrastructure investments and reducing bureaucracy).

2 KDZ – Zentrum für Verwaltungsforschung (Centre for Public Administration Research).

FISKALRAT
Austrian Fiscal Advisory Council

Adaptations of the national fiscal framework (2012 Austrian Stability Pact) are called for

The **2012 Austrian Stability Pact** (2012 ÖStP) lays down **subsectoral fiscal targets** with a view to compliance with the EU fiscal framework. Once **fully implemented**, the 2012 ÖStP will be a **multidimensional fiscal framework** similar to the EU-wide fiscal framework. The 2012 ÖStP has to be applied by the **central government** (without social security funds), the **regional governments** and **local governments in each province**.

However, the **interpretation of the 2012 ÖStP** is **controversial** among the contracting partners (central, regional and local authorities) **regarding several aspects**; furthermore, its **full application** (from 2017 onward at the latest) is **complex** and – **to some extent – delivers results that deviate from those obtained through the application of the EU fiscal rules**.

The **Fiscal Advisory Council** recommends that remaining **controversial issues be resolved quickly, that the national fiscal rules be simplified, in particular at the local level, and that differences** in the basic approach of the **national and EU rules be kept to a minimum**. Furthermore, more focus should be put on the **ex ante monitoring of subsectoral budget outcomes** in Austria in order to be able to identify potential breaches of rules early on. The Fiscal Advisory Council does not support the idea of retroactively **applying the 2012 ÖStP in full from 2015 onward**; from today's perspective, this does **not seem helpful**.

The Fiscal Advisory Council's main proposals for adapting the 2012 ÖStP include:

- **shortening the schedule for the ex post assessment** of rules compliance on the basis of final accounts data in the spring t+1;
- **aligning the national fiscal rules and relevant IT calculation tools** with the EU framework (in particular with regard to the debt rule);
- **including the social security funds**, which account for more than one-third of government expenditure, into the **expenditure rule**;
- **reducing the complexity** of national subsectoral fiscal rules **in particular at the local level**;
- **ensuring transparency and a free flow of information** between organizational units involved in the evaluation process (Statistics Austria, Court of Audit, coordinating bodies, Fiscal Advisory Council) and a **clear definition of interfaces**.

Noncompliance with national fiscal rules expected for 2016 and 2017

Regional and local governments fulfilled the Maastricht deficit requirements as set out in the 2012 ÖStP **until 2015,** but may have **deviated** from the objective **in 2016 –** this was found by **a report** that **Statistics Austria published in fall 2017** to highlight 2013–2016 budgetary outcomes against the background of the 2012 ÖStP rules. As regards the evaluation of subsectoral budget data, the applicable 2012 ÖStP rule ensures that individual cases of noncompliance (e.g. by local authorities in Burgenland and Upper Austria in 2015 or by the regional government of Styria in 2014) will remain without consequence if they are compensated for by other regional or local authorities that have performed better than required. The body responsible for reviewing compliance with the 2012 ÖStP rules and for identifying any related breaches is the **Court of Audit**. Its report will be published in the course of 2018.

According to information provided by Statistics Austria in fall 2017 and the Fiscal Advisory Council's own findings, overall, the **central and regional governments** are expected to deviate from the **2016 targets set for the Maastricht balance, whereas the local authorities seem to be in compliance**. The same results can be anticipated for the **debt rule** (in force from 2017) and the **structural budget balance**. At the **general government level**, **noncompliance with the 2012 ÖStP can be expected for 2016**, even if surpluses are factored in to offset subsectoral rules breaches. Under the EU fiscal framework, however, Austria was in compliance with the debt rule in 2016.

The national fiscal rules must be applied in full **from 2017 onward** at the latest. This implies that a **structural budget deficit** of no more than 0.45% of GDP (central government and social security funds: 0.35%; regional and local governments: 0.10% of GDP) as set out in the 2012 ÖStP must be complied with. From this moment on, central, regional and local authorities must record **deviations from their relevant structural targets in control accounts**. If negative balances on such accounts exceed certain thresholds (about 1.6% of GDP in sum), they must be **reduced in the subsequent years in line with cyclical developments** (automatic correction mechanism).

The **report about the 2017 budgetary outcomes** prepared by Statistics Austria is expected to be published in fall 2018. **From today's perspective**, it can be expected that Austria **breached the debt rule** in 2017 but **met its structural balance target** (**taking into account unusual event provisions**) at the general government level (national target: –0.45% of GDP, EU target: –0.5% of GDP). Likewise, Austria's 2017 **Maastricht balance is expected to be in line with the national rules**, given that, from 2017 onward, the target value will take into account the permissible structural budget deficit as well as the volume of one-off measures and the cyclical effect and given that the deficit threshold of 3% was complied with. Under the EU fiscal framework, Austria fully complied with its 2017 budget targets.