FISKALRAT
Austria

RECOMMENDATIONS FOR CURRENT AND MEDIUM-TERM BUDGET POLICIES (JUNE 2024)

Background: According to the current fiscal forecast of the Fiscal Advisory Council, the general government deficit will increase significantly – to 3.4% of GDP – in 2024. This rise is attributable, in particular, to the weak economic environment, the lagged effect of the high inflation seen in previous years – more specifically, high expenditure on welfare benefits and compensation of employees in the public sector – and slower revenue growth compared to previous years as well as the persistently high budgetary impact of past economic stimulus measures. The budget deficit is expected to shrink only marginally over the medium term. This will go hand in hand with a continuous rise in the government debt ratio, from 78.5% of GDP (2024) to 82.4% of GDP (2028). Contrary to previous years, nominal GDP growth will not suffice to offset the debt-increasing effect of the budget deficits. In sum, the fiscal environment can be characterized as follows:

- Projected breaches of both Maastricht criteria: over the medium term, Austria will remain consistently above the Maastricht deficit cap of 3% of GDP, and the government debt ratio will be rising continuously.
- The deterioration in the debt ratio will negatively affect Austria's rating and refinancing conditions compared to triple-A countries like Germany, Switzerland or Denmark.
- The new EU fiscal framework, which came into effect at the end of April 2024, means that additional consolidation will be necessary for Austria to comply with the new EU fiscal rules.
- Without compensatory measures (either on the revenue or the expenditure side), the abolition of bracket creep and the indexation of certain expenditure categories (e.g. family benefits) to inflation, which was introduced at the same time, will create a significant deficit, which in the past has been temporarily concealed by automatic inflation-related increases in revenues.
- The structural budget deficit is becoming increasingly entrenched because of an increase in expenditure on health, long-term care and pensions given the ongoing ageing of the population, and as a result of the discretionary reduction in revenues (cuts in income and corporate income taxes, abolition of bracket creep in income tax).
- The Federal Ministry of Finance's official budget planning documents do not indicate that the local, regional or central authorities have the objective, or a medium-term strategy, to consolidate the general government deficit and achieve long-term debt sustainability.
- At the moment, there is no fiscal space for economic stimulus that may become necessary in the future, for the creation of budget buffers to prepare for future crises or for future investments to address the numerous economic and social as well as health- and climate-related challenges.
- The climate emergency and demographic change can be expected to generate significant additional financing needs and are therefore posing a substantial risk to the budget.
- The widening of the fiscal sustainability gap due to population ageing, which was reinforced by past ad hoc intervention in the statutory arrangements for automatic increases in pensions, will be accelerated by inflation-related high growth in pension expenditure (which will eat up as much as 15.2% of GDP in 2024).
- There is a need for reform in the health and long-term care system (e.g. eliminating

inefficiencies in health care caused by a fragmented system) to help close the fiscal sustainability gap permanently.

- Steps initially planned to prepare for reforms of responsibilities and structures, for a reform of the tax system (to, inter alia, strengthen the tax autonomy of subnational entities in line with the fiscal sharing agreement) as well as for efficiency-increasing measures for government functions have not yet yielded any results.

Against this background, the Fiscal Advisory Council, on June 12, 2024, adopted the following recommendations:

Reducing structural budget deficits in a timely and sustainable manner to regain fiscal space

- The federal government needs to: develop a comprehensive consolidation plan with both revenue- and expenditure-based measures that takes into account macroeconomic and distributional feedback effects. Empirical analyses indicate that expenditure-related consolidation measures have a more sustainable budgetary impact (Aiginger et al., 2010)[1];

- ensure long-term debt sustainability by reducing structural budget deficits in a sustainable manner, taking into account EU legislation under the Stability and Growth Pact;

- explore and tap into potential for revenues and savings (avoiding undesirable multiple subsidization, reducing deadweight losses, etc.);

- phase out, without delay, temporary crisis-related support measures;

- refrain from adopting measures without providing for compensatory funding, especially in the run-up to the general elections;

- develop and implement targeted climate policies to reduce climate-related risks to the budget that may materialize as costs of non-action (environmental damage, additional health costs, etc.), costs incurred through the purchase of emission certificates or penalties in case of failure to meet emission reduction targets. The choice of climate policies needs to take into account cost efficiency considerations, especially with regard to public infrastructure investments, greening the tax system, carbon pricing, legal requirements, reviewing subsidies for their ecological impact, financing the transformation.

Rebuilding resilience to crisis in an environment that is still marked by uncertainty

- The government needs to: use the necessary reduction in the government debt ratio to gradually create fiscal space and budget buffers, thereby providing for conditions under which future crises can be managed and challenges arising from demographic and digital change and the climate emergency can be addressed;

- strictly adhere to the budget and to prudent spending wherever possible to support the financing of future investments and the creation of budget buffers;

- establish a household income database that can be used by public authorities and refine the criteria for subsidies to businesses to better ensure that public support goes where it is really needed; minimize conflicts between the objectives of subsidies and minimize multiple subsidies, and further enhance transparency among local, regional and central authorities to

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

keep costs low.

Full compliance with the new EU fiscal rules

- The government needs to: integrate a long-term fiscal consolidation plan (with both revenue- and expenditure-based measures) into the national fiscal structure plan, which must comply with the rules of the new EU fiscal framework and be submitted to the European Commission in September 2024;
- adopt the national budgetary framework in line with EU rules in a timely manner when establishing the specific requirements to be fulfilled by central, regional and local authorities, aiming, in particular, at reducing complexity and enhancing steering effects;
- coordinate activities at the central, regional and local government levels regarding reform and investment plans that support sustainable economic growth and sustainable public finances and at the same time can extend the adjustment period, thereby reducing the annual general government consolidation need;
- develop, without delay, transition arrangements for previous instances of noncompliance and associated consolidation requirements on the basis of the 2012 Austrian Stability Act that accumulated until 2019 (before the general escape clause was activated) and those that are arising from the emerging imbalances in the 2024 fiscal year;
- publish the statements of the federal government on the Fiscal Advisory Council's analyses and recommendations in a timely manner, i.e. within two months, in line with EU Directive 2024/1265;
- mandate the EU debt sustainability analysis task force, which is to be established for developing methodological improvements, to also address the question of how to reduce complexity.

Keeping a lid on demographic-related spending to ensure sustainability in the long run

- The government needs to: press ahead with structural reforms in areas with responsibilities across different levels of government (in particular, education, health care, long-term care) to unlock efficiency potential;
- 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 so as to safeguard its 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 ensure equal 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.