

Workshop: “The Inflation Hangover in Public Finances”

Welcome and opening remarks

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- **Institutional opening: why does the Fiscal Advisory Council care about inflation?**

The topic is not inflation in general, but inflation as a challenge for fiscal sustainability, budget planning and independent fiscal surveillance. The “inflation hangover” captures precisely what matters for fiscal policy: the delayed effects of a high-inflation episode that become visible only after headline inflation has passed its peak.

- **Core message: fiscal timing asymmetry**

Inflation affects public finances with different time lags. Revenues often react first, while expenditures react later. Higher nominal tax bases can temporarily improve the budget balance and reduce the debt-to-GDP ratio mechanically. But delayed spending increases, higher interest costs and weaker macroeconomic dynamics can reverse this improvement. The key message is: **inflation may create the appearance of fiscal space before it creates fiscal pressure.**

- **Fiscal impact of inflation especially relevant for countries like Austria**

This issue is especially relevant for Austria, since it is a state with a large and generous welfare-system and therefore high price indexed government expenditures. Pension expenditure, social transfers, public-sector wages and public investment all transmit inflation into future budgets. Indexation protects the purchasing power of households and stabilizes social cohesion, but they also carry past inflation into future expenditure.

- **Austrian evidence:**

Holler/Reiss 2023 provide evidence for Austria: They show that the 2021/22 inflation shock initially improved the budget balance slightly, but that the medium-term to long-term effect is substantially negative. This development is due to three main factors: the deviating time profile of revenue and expenditure reactions and the deviating behavior of national prices and imported prices.

- 1. Timing: Direct fiscal effects versus delayed effects

Direct effects include higher VAT revenues, higher wage-related tax revenues, higher social security contributions and higher nominal GDP. Delayed effects include pension adjustments, social-transfer indexation, public wage agreements, intermediate consumption (energy costs...), investment costs, and interest expenditure. This explains why fiscal data during a high-inflation episode may look better than the underlying position that materializes in the medium-run really is.

- 2. National vs. imported prices:

The difference between GDP-deflator and CPI is especially relevant for an imported inflation shock where revenues react stronger to the GDP-Deflator than expenditures. In the case of the

recent energy price shock Austrian CPI was substantially larger than the GDP-deflator. This implied that the price induced expenditure increases exceeded price induced revenue increases.

- 3. Real macroeconomic shock

The recent high-inflation episode also resulted in a real macroeconomic shock. Lower economic activity results in lower revenues and slightly higher expenditures (rule of thumb: 1PP lower real GDP results in a 0,5PP deterioration of the fiscal balance). **Fiscal policy cannot eliminate that loss; it can only distribute it across households, firms, the state and future taxpayers.**

Austria's 2022/23 response

Austria's policy response included a broad range of measures: the electricity cost brake, anti-inflation and cost-of-living bonuses, support for pensioners and families, housing and heating support, energy-related relief and support for firms. Prammer/Reiss 2023 show that Austria relied strongly on income-support measures compared with some other EU countries. These measures stabilized disposable incomes and reduced hardship, but they also caused soaring deficits.

Policy-design question: price interventions versus transfers

The discussion on the optimality of fiscal policy reaction will be covered in the final panel and by Alena Harrer-Bachleitner's contribution on price interventions versus transfers. Price interventions can reduce measured inflation and provide immediate relief, but they may weaken price signals and become costly. Transfers can be more targeted and transparent, but their distributional and demand effects depend on design. The key issue is not whether governments should help, but how precisely and for how long they help.

Positioning the workshop sessions

Session 1 on "Inflation shocks and public finances: stylized facts," chaired by Elisabeth Springler, provides the empirical foundation. Dubravko Mihaljek's work highlights the international pattern: high inflation can initially boost fiscal revenues, while expenditure catches up later. Clemens Jobst adds the long-run Austrian historical perspective. Session 2, chaired by Margit Schratzenstaller, turns to long-term fiscal impacts. Philipp Rother brings the ECB and euro-area perspective; Nicolas Carnot adds the fiscal-institution and debt-sustainability perspective.

Current geopolitical relevance

Current Middle East and Iran-related tensions remind us of that energy-price shocks remain a live risk. The lesson from 2023 is that future fiscal responses should protect vulnerable households quickly, avoid automatic broad compensation, preserve price signals, keep measures temporary and strengthen energy resilience through diversification, grids, storage, efficiency and lower fossil import dependence. Unfortunately, the Austrian fiscal position has severely weakened compared to the situation before the 2023 inflation shock. This limits the scope of potential crisis-related measures and is a part of the rather weak discretionary reaction of the government to the current energy price shock.

Closing message

Inflation-driven revenue gains should not mistakenly be taken as structural fiscal space. Delayed expenditure effects are central to the fiscal hangover. Indexation protects households but extends fiscal pressure. Crisis measures may be necessary, but they must remain targeted, temporary and credible. The workshop's purpose is to clarify stylized facts, understand long-term fiscal consequences and discuss optimal policy responses to be better prepared for sudden future inflation shocks.