FISKALRAT
Austria

Recommendation of the Fiscal Advisory Council on Austria's Budget Policy and Budget Financing in 2014

Adopted at the Fiscal Advisory Council meeting on July 2, 2014

Framework Conditions

In its World Economic Outlook of spring 2014, the IMF expects global real GDP growth to accelerate from 3.0% in 2013 to 3.6% in 2014 and further to 3.9% in 2015. The advanced economies, in which downside risks have diminished somewhat against the previous year, will provide the main growth impulses. The European Commission forecasts moderate economic growth of 1.2% in 2014 (2013: –0.4%) for the **euro area**, and a slight acceleration of growth to 1.7% in 2015. The recovery will gradually spread to all euro area countries, reaching Cyprus only in 2015. Domestic demand is augmenting and making an important contribution to growth once again. However, a small number of euro area countries is experiencing deflation, indicating a pronounced weakness of demand. Although the repercussions of the economic and financial crisis – high private and public debt, high unemployment and tight credit supply – have eased, they continue to weigh on economic growth.

Breakthroughs have been achieved in various aspects of the legislative proposals to establish **banking union** in the member countries of Economic and Monetary Union. The core elements of banking union include a single supervisory mechanism (SSM), a uniform framework for the recovery and resolution of credit institutions, and a common deposit guarantee scheme whose introduction will necessitate an adaptation of the deposit guarantee scheme for credit institutions in effect in Austria. The adoption of bank insolvency legislation is designed to ensure that owners and creditors, rather than taxpayers, bear the cost of insolvency.

In **Austria**, too, the moderate upswing is fueled by domestic demand and is set to accelerate from between +1.4% and +1.6% real GDP growth in 2014 to +1.7% and +1.9% real GDP growth compared to +0.3% in 2013.[1] Capacity utilization at companies is on the rise again. After having contracted in 2012 and 2013, investment is expected to expand again. Especially investment in plant and equipment is set to increase at an above-average rate. This development is supported by the lower leverage of Austrian companies than of euro area companies and by the favorable financing conditions resulting from expansionary monetary policy. Household consumer spending is anticipated to quicken marginally. Household real disposable income, which dropped in 2013, has begun to rise again. International framework conditions , above all geopolitical tensions – like the Ukraine crisis – represent a risk to the Austrian economic recovery. Austria has not exhibited deflation tendencies; the Harmonised Index of Consumer Prices (HICP) is calculated to rise to 1.7% to 1.8% in 2014.

In the **Austrian labor market**, the number of actively employed persons has risen year on year so far in 2014, like in previous years (2014: +35,000 persons; 2013: +30,300 persons), as has the number of registered unemployed persons (2014: +24,000 persons; 2013: +26,600 persons).[2] This development reflects the current capacity underutilization in the economy as well as the widening of labor supply resulting from the opening up of the Austrian labor market to job seekers from Southeastern European countries since 2011. The economic research institutions WIFO and IHS as well as the OeNB assume that Austria's unemployment rate (Eurostat definition) will edge up from 5.0% to 5.2% in 2014 (2013: 4.9%). Austria's jobless rate is forecast to remain the lowest rate in the EU, however.

The abrogation of the excessive deficit procedure (EDP, corrective arm of the Stability and Growth Pact) for Austria means that from 2014, the provisions of the **preventive arm** apply. Compliance with

1 June 2014 data of the Austrian economic research institutions WIFO and IHS as well as of the OeNB.
2 Source: WIFO (as at June 2014).

the preventive arm means that the following provisions come to bear (unless special provisions take effect in the case e.g. of natural disasters or of a severe economic downturn):

- Sustainable observance of the **Maastricht deficit limit** of 3% of GDP;
- An **annual improvement of the structural balance** (cyclically adjusted budgetary position net of one-off and other temporary measures) **of more than 0.5% of GDP**as long as the medium-term objective (MTO) has not been achieved and as long as the debt ratio exceeds the reference value of 60% of GDP. If Austria strictly complies with the structural budget balance rule, it should attain the **MTO already in 2015**;
- **Limitation** of annual (real-term) **government expenditure growth** to the reference medium-term rate of potential GDP growth minus an adjustment (of 1 percentage point for Austria), unless the excess is matched by discretionary revenue measures;
- **Reduction of the public debt-to-GDP ratio** during a **three-year transition period** (2014 to 2016) to a benchmark that is to be determined on the basis of the minimum adjustment of the structural budget balance and that must ensure compliance with the debt rule by the end of 2016. The debt rule has been met if the **general government debt ratio has been reduced at a rate** at which the **difference to the reference value of 60% of GDP diminishes by an average of 5% a year** over the previous three years (years t-1 to t-3) or on the basis of the European Commission forecast ("no-policy-change" assumption, years t-1, t and t+1).

This EU system of multidimensional fiscal rules was transposed into Austrian law by the **2012 Austrian Stability Pact**. This pact in particular established the **MTO** of a **structural general government budget deficit** of a maximum of **0.45% of GDP from 2017** (central government and social security funds: 0.35% of GDP; state and local governments: 0.1% of GDP).

According to the **updated Austrian Stability Program**me, the general government budget balance (Maastricht definition) will increase on account of a **one-off effect in 2014** related to the restructuring of Hypo Alpe-Adria-Bank, rising perceptibly from 1.5% of GDP in 2013 to 2.7% of GDP only in 2014. This rise results from the EUR 1.4 million additional capital requirement of the bank until it is transferred to a wind-down vehicle (most likely in fall 2014) and an assumed writedown requirement of up to EUR 3 billion. In 2015, the general government budget deficit will be lower again and will be continuously **reduced in the next few years**. From 2016, the general government budget deficit is expected to be well below 1.0% of GDP (2016: 0.7% of GDP; 2018: 0.5% of GDP).[3]

From the current perspective, Austria is **not likely to fulfill all EU requirements**; in particular, it will not meet the structural balance adjustment requirement (see the fiscal rules report – Fiskalregelbericht – of May 2014). Therefore, the current **budget plans** for Austria cannot be interpreted as providing any room for maneuver to cut taxes across the board or to introduce additional proactive measures except in the case of counterfinancing. The **Council of the European Union** also observed in June 2014 that while Austria had corrected its excessive deficit in a sustainable manner, the **danger of a significant deviation from the structural adjustment path** toward the MTO continued to persist in 2014 and 2015. As laid down in the **opinion of the Austrian Federal Ministry of Finance**, a significant deviation as defined in the Stability and Growth Pact from the structural adjustment path toward the MTO must be prevented by additional measures in implementing the budget, if necessary.

3 Revisions of key macro data and fiscal indicators as a result of the transition to the ESA 2010 national accounts system in October 2014 were not taken into account in the current Stability Programme from 2013 to 2018.

Recommendations of the Fiscal Advisory Council

Against the background of high government debt, fiscal requirements based on EU legislation and the anticipated economic framework, the **Fiscal Advisory Council issues the following recommendations for 2014 and for the medium-term budget path**:

- The planned **consolidation course** should be more closely linked with **elements of growth** and the commitment to observe EU fiscal rules, which would improve **the quality of public finances**, facilitate observance of the **consolidation course**, and prevent **negative repercussions** on growth and employment. This includes the following aspects, among others:
    - Taking **decisions** about federalism reform, i.e. **reforms of the tasks, competences and structures of the federal, state and local authorities**, among other things with regard to more efficient administration, education, pension legislation applicable to civil servants, subsidies and public transport at the regional and local levels, and **resolutely implementing these decisions during the current parliamentary term**. The reform should have the objective of consolidating the responsibility for tasks, expenditures and financing of public services, which will enhance the outcome orientation of and the incentive mechanisms for a sound fiscal performance by strengthening direct responsibility and transparency.
    - **Taking greater account of EU requirements**, which calls for an adjustment of the structural budget balance in line with the MTO, by frontloading structural measures (e.g. in the areas of subsidies or pensions). **Subsidies** could be made more efficient among other things by addressing conflicting objectives that result from the interaction between separate promotion measures. To this end, a comprehensive strategy establishing a focus for subsidies (e.g. on economic growth, green measures) could be adopted. Moreover, governance rules calling for transparency at all government levels could be passed, overlaps between subsidies and the large number of bodies responsible for granting subsidies could be reduced, and the basis for decisions to grant subsidies as well as control and evaluation measures could be improved.
    - Introducing an overall strategy and a framework that together raise the level of educational attainment, innovative strength and Austrian research output. Budget consolidation measures in education should therefore be targeted at **improving efficiency** and **preventing redundancies** to free up funds for the overarching goal of raising the level of educational attainment and improving education quality.
- **Tax reform** compliant with **EU fiscal rules** should be implemented as soon as possible. The reform should, in particular, relieve the tax burden on **labor** and should be financed by sustainable expenditure cuts and reassignments between tax categories.
- Defining the **central objectives and principles of a fundamentally new fiscal sharing architecture** at the highest political level, allowing for a targeted and efficient design of the reform process scheduled to start in fall 2014. The Fiscal Advisory Council maintains that the reform framework should be based on the following principles:
    - Reinforcing **direct responsibility** by reducing mixed financing;
    - Strengthening the principles of **fiscal connection** (linking the tasks vested in each government level with responsibilities for public expenditures and their financing);
    - Providing for **funding oriented on tasks**, ensuring an equalization of burdens in demographic, topographic and locational terms;
    - Considering the **fiscal performance capacity** of the central, state and local government authorities, e.g. by an equalization of resources for structurally weak regions.

  - Ensuring **transparency** of flows of funds and uses of funds;
  - Implementing **outcome-oriented control** and **monitoring** measures.

- Containing **explicit and implicit contingent liabilities** by applying unambiguous **legal standards, risk management** methods and **transparency**. The following measures are well suited to implementing this containment:
  - Application of stringent, unambiguous legal standards for investment and (low-risk only) financing transactions (**prohibition of speculation**) as well as **uniform accounting rules** for all levels of government and accountability (reporting requirements) to Parliament and the public;
  - Continuous obligatory strategic **risk management** measures (at the individual and general government level) for large explicit and implicit contingent liabilities (stress tests, scenario analyses) with **stringent guarantee limits** for individual local, state and central government bodies. Application of **procedural rules** in the event of the **imminent insolvency** of individual government bodies, in particular clarification of the liability relationships between the government bodies. Provision must be made for the temporary withdrawal of fiscal sovereignty at the state and local level in extreme cases. Currently, no legal provisions exist for such cases;
  - **Publication of all documents related to the budget**, including their treatment in Parliament and in the regional parliaments, unless legitimate interests to the contrary exist.
- The long-term sustainability of public finances must be ensured by implementing **structural reforms**, in particular in **age-related areas** (pensions, long-term care, health). Without structural measures, financing gaps will widen and exercise consolidation pressure on future investment. Structural reforms would be particularly relevant in the following areas:
  - With regard to **pensions**, the actual age of retirement should be raised to a level more closely aligned with the legal retirement age, and rising life expectancy should be factored in.
  - With regard to **long-term care**, further measures should be taken to sustainably cope with cost increases (development of harmonized care standards for access to care, for care benefits and for costs; these standards may also help raise administrative efficiency; extension of mobile and outpatient services) and to build a viable financing model.
  - With regard to the planned **healthcare reform**, a substantial shift from inpatient to outpatient and primary care services should be intensified for cost, efficiency and quality reasons.