EXECUTIVE SUMMARY

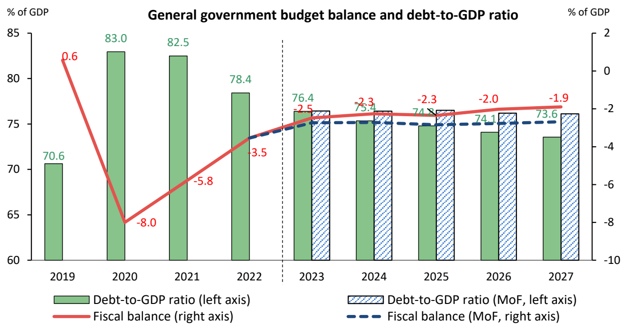
- The Fiscal Advisory Council expects high budget deficits over the entire forecast horizon. The declining, yet still high, budgetary burden resulting from crisis-related measures will lead to a high budget deficit of 2.5% of GDP in 2023. The ongoing discontinuation of temporary crisis-related measures will cause the budget deficit to drop to 1.9% of GDP by 2027. A more marked improvement of the budget deficit is prevented by additional economic policy measures, in particular additional expenditure on defense, climate protection, long-term care and health care, and – on the revenue side – through the elimination of bracket creep and the eco-social tax reform, coupled with subdued real GDP growth. Public debt is projected to drop only slightly from 76.4% of GDP in 2023 to 73.6% of GDP by 2027, despite high nominal GDP growth. Thus, the debt-to-GDP ratio will clearly exceed its pre-pandemic 2019 level of 70.6% of GDP, even in the medium term.

- In its draft budgetary plan, the Austrian Federal Ministry of Finance expects a slightly higher budget deficit – 2.7% of GDP for 2023 –than the Fiscal Advisory Council. According to its strategy report, the Ministry of Finance does not see budgetary improvements in the medium term, unlike the Fiscal Advisory Council. The Ministry of Finance budgets both higher expenditure and higher revenue than the Fiscal Advisory Council. Higher budgeted expenditure, which implies that the government is seeking to create additional fiscal space, is responsible for the high deficits projected in the draft budgetary plan. According to the Ministry of Finance, the debt ratio will fall only slightly to 76.1% of GDP by 2027 despite high nominal GDP growth.

- Despite the recession, government revenue will increase significantly in 2023 on the back of the rise in employment and high wage settlements. In the years after 2023, revenue growth is set to decelerate in line with real GDP growth. The high inflation seen since end-2021 is improving the fiscal balance in the short run thanks to higher revenue. Over the medium term, however, high inflation is also leading to expenditure increases, e.g., due to higher public spending on pensions and higher interest payments.

- On account of the recession in 2023, the output gap will be mildly negative, resulting in a structural budget balance (adjusted for the cyclical budget component) that is only marginally higher than the budget balance over the entire forecast horizon. The clearly expansionary fiscal policy stance, which comprises extensive crisis management measures, is also reflected in high structural budget deficits in the medium term.

- While the Maastricht deficit will remain below the 3% of GDP criterion over the entire forecast horizon, the slow reduction of the debt ratio will not comply with the current requirements of the Stability and Growth Pact from 2026 onward. Due to the regime change following the deactivation of the general escape clause, structural budget requirements, which will clearly not be met, will start to apply again from 2024. In 2024, Austria will be narrowly in compliance with the new upper threshold for the nominal increase in net primary expenditure as defined in the European Commission's proposal on reforming European fiscal rules.



Source: Statistics Austria, FISK autumn forecast 2023 and Draft Budgetary Plan 2024. MoF = Ministry of Finance.

RECOMMENDATIONS BY THE FISCAL ADVISORY COUNCIL ON AUSTRIA'S BUDGET POLICY FOR 2024

Swiftly improving crisis resilience and restoring a sustainable fiscal position is key

Background: Based on its latest fall forecast, the Fiscal Advisory Council expects budget deficits to remain high in the medium term despite expiring crisis-related support measures. The government debt ratio will drop only slightly, even in the medium term. These developments are due to expansionary fiscal policies that do not appear warranted given current economic conditions. We expect Austria to significantly deviate from the targets laid down in the European fiscal framework. Moreover, as the debt ratio and structural deficit levels are projected to remain too high over the medium term, it will become increasingly difficult to make necessary investments for the future, and the long-term sustainability of Austria's public finances will be at risk.

Recommendations:

- Creating fiscal space is essential in order to prepare for new challenges and crises and be able to make necessary investments for the future – even more so in times of multiple crises and great uncertainty, an aging population and potential costs resulting from the consequences of climate change and the failure to meet climate objectives. The current fiscal situation determines the room for maneuver to respond to future social, economic and climate challenges.
- Improving conditions for sound economic growth substantially contributes to strengthening fiscal sustainability; such improvements can be achieved through, e.g., labor qualification measures, public seed investments and complementary investments fostering the green and technological transformation, and structural reforms in areas affected by demographic change.
- In the run-up to the parliamentary elections in fall 2024, it must be ensured that parliamentary decision-making processes will not be cut short. Additional expenditure packages should be avoided or at least be accompanied by corresponding funding measures. This should help ensure that decision-makers have comprehensive information on the effects of planned economic policy measures, reforms and decisions and guarantee the stability of public finances.
- Efforts should be made to push ahead with the creation and further development of an appropriate data basis providing information on Austrian households' income to increase the effectiveness of support measures in the event of future crises and to effectively align financial flows with households' income levels, given the tight budget situation. There is, in general, the need to carefully consider in each case whether and to what extent government intervention would be effective.

Implementing structural reforms to create and expand fiscal space for necessary investments for the future

Background: The present medium-term general government budget program is just within the nominal budget requirements, meaning that even minor deviations from the planned revenue and expenditure path will cause Austria's general government deficit to exceed the Maastricht criterion of 3% of GDP. As a result, Austria would become subject to an excessive deficit procedure. This also means that the short-term room for fiscal maneuver identified in the Fiscal Advisory Council's 2021 Sustainability Report has already been exhausted owing to the significantly worsened fiscal path than the one projected in 2021. At the same time, necessary structural reforms have not been implemented. What is more, the current budget plans are not adequately addressing medium- and long-term challenges and the ensuing large additional financing needs, which mainly arise from demographic change and the green and digital transformation. As a case in point, e.g., the investment ratio declines over the medium term despite the need for major investments in order to meet the climate targets.

Recommendations:

- Policymakers should create room for fiscal maneuver to avoid welfare cuts and to address the many current social, economic and environmental challenges.
- To this end, we need a comprehensive outline of how public finances will be financed in the long term, which should also cover the financing of investments for the future and anti-crisis measures as well as measures aimed at slowing down spending growth.
- The sustainability of public finances should be ensured by implementing structural reforms, especially in health care, long-term care, pensions, education and labor markets. In particular, these reforms should aim to:
- generate efficiency gains, in particular by disentangling responsibilities and financing across the different levels of government; and
- increase the frequency of general government spending reviews to raise transparency and help identify both issues that require action and options for addressing them.
- We need additional efforts to meet the binding European climate targets, and measures must be implemented in a timely manner. In doing so, however, cost efficiency and, if applicable, the financing of required measures must also be borne in mind.
- Finally, preventing energy poverty is of utmost importance, especially in view of high energy and rising CO_2 prices.

Actively representing and practicing fiscal discipline within the EU's rules-based fiscal framework – at both the national and the international level

Background: At the European level, discussions are still ongoing to reach agreement on the reform of the EU fiscal framework. The most important elements of the current reform proposal are simplifying the fiscal rules and promoting fiscal rules ownership at the member state level. Differentiated, medium-term national fiscal structure plans are to set out upper limits for budget paths on the basis of a single operative indicator, i.e. net primary expenditure. The fiscal structure plans are to offer more flexibility for growth-enhancing reforms and investments, especially in the context of the green and digital transformation. At the same time, they are to ensure an ambitious – albeit slower – path toward debt reduction by the member states. All of these changes will also need to be incorporated into the national fiscal framework (Austrian Stability Pact – ÖStP), which comprises the contributions of all levels of government; in doing so, it must be ensured that the new rules serve their purpose and have the intended steering effects.

Recommendations:

- Austria's federal government should actively contribute at the EU level to promoting fiscal discipline within a rules-based fiscal policy framework.
- In doing so, Austria's federal government should ensure consistency between their calls for a new fiscal framework at the EU level and budget planning at the national level. National budget planning must be in line with binding EU fiscal rules.
    - After the deactivation of the general escape clause from 2024 onward, member states must comply with the structural budget rules under the current EU fiscal framework, as long as the reform of the framework has not been adopted.
- Placing greater weight on medium-term spending as proposed by the European Commission is in line with previous recommendations by the Fiscal Advisory Council, as this contributes to an improved

steering effect and a stronger medium-term orientation. Changes to the EU's fiscal framework do not preclude the continued consideration of the structural budget balance as a key figure for fiscal policy orientation and analysis in the interest of a sustainable fiscal framework that adequately takes into account the requirements of the business cycle.

- In the process of drawing up a new EU fiscal framework and thus meeting the obligation to adapt national fiscal rules, all parties to the Austrian Stability Pact as well as the Austrian Coordination Committee will have to examine how to best translate measures to correct previous breaches, including those from 2024, into the new context.

- As long as it is not possible to establish new national fiscal rules in line with the reform at EU level, Austria must start correcting negative control account balances which built up due to deviations from structural budget targets up to the year 2019. This must be done in 2024, as set out in the 2012 Austrian Stability Pact.

Consistently implementing the objectives of the new fiscal sharing agreement

Background: In Austria, funding for regional and local governments is largely dependent on financing flows across the different levels of government. These financing flows, in turn, are strongly determined by the country's institutional and legal set-up (as regards the division of responsibilities, tax powers, revenue sharing rules). In early October 2023, representatives of all levels of governments reached an agreement in principle for the new fiscal sharing arrangements for the period from 2024 to 2028. In December, the lower house of parliament passed the overall fiscal sharing package, which provides up to EUR 3.4 billion in funding per year. The Fiscal Advisory Council forecasts that these funds will not be fully used in the short run. The funds are planned to be used, for the most part, for health care, long-term care and a "future fund," which is to be set up to provide additional funding for childcare, housing/renovation and environmental and climate protection measures. The Fiscal Advisory Council criticizes the fact that the targets specified under the future fund are not binding; hence, failure to achieve targets does not mean that the original measures will be revised and that the disbursement of funds will be put on hold. Importantly, when targets are not achieved, the first course of action must not be to adjust the targets.

Recommendations:

- To make the best possible use of target-oriented fiscal sharing, a transparent and publicly accessible monitoring system should be established and measures should be evaluated to determine whether they are suitable and contribute to meeting the targets.

- In addition to the new fiscal sharing agreement, initiatives and important structural reforms should be advanced to increase the efficiency of financing and spending arrangements across all levels of government in Austria. This includes in particular:
    - aligning government tasks with the power to tax and the power to spend, and establishing fiscal equivalence (i.e. a match between those who receive benefits of a public good and those who pay for it);
    - promoting a more task-based allocation of funding in the context of a reorganization of government tasks;
    - strengthening the tax autonomy of regional and local governments;
    - disentangling and reducing financing flows across the different levels of government; and
    - establishing an overall strategy and a national coordination mechanism for subsidies and investments, particularly regarding joint efforts to manage the green transformation.

Advancing the legal fiscal framework to improve transparency and the ability to manage public finances, taking administrative costs into account

Background: The second part of the federal fiscal framework reform was implemented ten years ago. The intention was to move away from one-year budget plans, cash-based accounting and a purely input-based approach, and toward binding multi-year plans, statements of cash flow, income and financial position, and gender budgeting. The aim of the reform was to establish mechanisms that put the focus on impact and resources and to achieve better budget management. Applying such mechanisms can raise the transparency and effectiveness of the budget process and the accountability of political decision-makers. However, the benefits of these mechanisms have not yet been fully harnessed. For instance, estimating the budgetary effects of changes to legislation plays a central role in economic governance. This is reflected in the federal government's fiscal framework, which requires the responsible ministries to conduct a regulatory impact assessment (RIA) for draft bills and reform projects that also have an impact in other areas, such as the environment, families, businesses, etc. When legislation is fast-tracked, e.g. when bills are put forward as parliamentary motions, information requirements are less stringent, meaning that important data on the impact and funding of reform proposals are unavailable. Especially in times of crises, when decisions have to be made quickly, many decisions are fast-tracked.

Recommendations:

- As the crisis mode comes to an end, it is necessary to return to a legislative process that consistently includes RIAs, sufficient comment periods and adequate deliberations in parliament. RIAs should reflect amendments in a timely manner to ensure that they provide a suitable basis for evaluation before legislation is passed.
- In addition, Austria needs suitable measures to ensure high-quality RIAs for legislative initiatives that have not been subject to strict RIAs so far, such as parliamentary motions, motions filed by parliamentary committees, legislative proposals submitted by the upper chamber of parliament and citizens' initiatives. This could be done in cooperation with parliament's Budget Office.
- The quality of the impact assessment within the framework of the RIA for draft legislation and of the compulsory ex post evaluation must be safeguarded and developed further.
- Budget law needs to be amended to reflect the findings of various evaluations of the latest reform of the framework and to implement improvements (see, e.g., recent recommendations by the Austrian Court of Audit and proposals by parliament's Budget Office). The aim should be to make greater and better use of the tools of the existing framework, such as medium-term budget planning, budget reserves, gender budgeting and impact-oriented management. This could be achieved by, among other things,
- providing meaningful, in-depth information to parliament to support the achievement of sustainable public finances;
- improving the ability of government to implement impact-oriented management by defining clear targets; and
- ensuring a better coordination of mechanisms across government ministries and levels of government and avoiding duplication of mechanisms and uncoordinated and inefficient structures in order to increase the transparency, effectiveness and impact-orientation of budget management.
- In addition, administrative costs and the proportionality of the administrative burden need to be taken into account.

Including climate-related fiscal risks in budget planning and forecasts

Background: Climate risks can cause considerable costs for public budgets. These include future expenditure on climate change adaptation, compensation for and remediation of damage caused by climate change, the purchase of emission certificates if climate targets are not met, the higher cost of government debt due to climate risks, and fiscal risks arising from lower economic growth and declines in the value of public assets due to climate change. Austria recently started to take account of climate-related risks for public budgets by discussing them and estimating their extent in certain areas, as reflected in the Federal Ministry of Finance’s long-term budget forecast, and in the documents on the federal budget and medium-term financial framework (budget report, climate and environment supplement to the federal budget).

Recommendations:

- Even though the full extent of the climate-related fiscal risks that Austria is facing cannot be quantified at this stage, they should be explicitly addressed in the relevant budget (forecast) documents.
- The inclusion of climate risks in budget planning and forecasts should be explicitly stated for important budget items. This relates in particular to the forecasts for interest expenditure, higher expenditure and lower revenue due to climate-related GDP and productivity losses and climate-related damage (e.g. higher health care expenditure, expenditure for the restoration of infrastructure and compensation payments following extreme weather events).
- Moreover, debt sustainability analyses, which currently focus only on the impact of demographics, should take into account fiscal climate risks.
- In identifying climate-related fiscal risks, adequate scenario techniques must be used, based on various sets of assumptions, to reflect uncertainties regarding future emissions trends, responses of the climate system and climate action.
- The federal government should, at all levels of government, close gaps in the data required to quantify fiscal risks resulting from climate change.
- At the same time, adequate methodological approaches should be developed to estimate climate-related risks.
- Successful climate policy can reduce fiscal risks. That said, cost efficiency has to be taken into account in selecting climate policy tools (especially with regard to public infrastructure investments, greening the tax system, carbon pricing, legal requirements, reviewing subsidies for their ecological impact, financing the transformation).

MAIN RESULTS

The economic policy environment in 2023 and 2024 continues to be characterized by the response to the successive crises. Temporary COVID-19 support and anti-inflationary measures continue to weigh on public finances but will largely be phased out by the end of 2024. We see that the focus of crisis-related intervention measures has been shifting from support for households to support for businesses. While defense, climate protection, long-term care and health care are policy areas gaining more attention over the medium term, we have not identified major investment initiatives.

Fiscal Advisory Council expects continuously high budget deficits

The Fiscal Advisory Council forecasts the general government deficit to remain at a high 2.5% and 2.3% of GDP, respectively, in 2023 and 2024, even though crisis-related measures will no longer have a budgetary impact. The deficit is expected to decrease somewhat in the medium term but will still reach a high 1.9% in 2027. The debt-to-GDP ratio will drop only slightly despite high nominal GDP growth.

Ministry of Finance allocates substantial funds to additional expenditure

The Austrian Ministry of Finance expects higher budget deficits than the Fiscal Advisory Council over the entire forecast horizon. More precisely, the Ministry of Finance anticipates the deficit to remain almost unchanged at 2.7% of GDP, while the Fiscal Advisory Council not only sees a smaller deficit in 2023 but also a further improvement to –1.9% of GDP by 2027. At the same time, the Ministry of Finance expects slightly higher revenues from direct taxes (in particular income tax) and social security contributions than the Fiscal Advisory Council. This implies that the projected higher deficits are solely the result of higher budgeted expenditure. This increase in expenditure, which we see across almost all categories, arises, in part, from differing estimates of the additional expenditure associated with the new fiscal sharing regime. For 2024, the Fiscal Advisory Council expects additional expenditure in the amount of no more than EUR 0.7 billion, whereas the Ministry of Finance sets this figure at EUR 1.9 billion. Table 1 provides an overview of the main results of the Fiscal Advisory Council's fall forecast and a comparison with the Ministry of Finance's draft budget.

Table1: Main results of the Fiscal Advisory Council's fall forecast and the Ministry of Finance's draft budget

			FISK autumn forecast 2023				
% of GDP	2021	2022	2023	2024	2025	2026	2027
Fiscal balance	**-5.8**	**-3.5**	**-2.5**	**-2.3**	**-2.3**	**-2.0**	**-1.9**
Cyclical budget component	-1.2	0.8	-0.3	-0.2	-0.1	-0.1	0.0
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural budget balance	**-4.6**	**-4.4**	**-2.2**	**-2.1**	**-2.2**	**-2.0**	**-1.9**
Real GDP (%, year on year)	4.2	4.8	-0.8	1.2	1.6	1.7	1.5
Potential output (%, year on year)	1.0	1.1	1.1	1.1	1.0	0.9	1.0
Output gap	-2.1	1.5	-0.4	-0.3	-0.2	-0.1	0.0
General government debt	**82.5**	**78.4**	**76.4**	**75.4**	**74.8**	**74.1**	**73.6**
Memo: Fiscal balance (MoF)	***-5.8***	***-3.5***	***-2.7***	***-2.7***	***-2.8***	***-2.8***	***-2.7***
Memo: General government debt (MoF)	***82.5***	***78.4***	***76.4***	***76.4***	***76.5***	***76.2***	***76.1***

Source: FISK autumn forecast 2023, Draft Budgetary Plan 2024, WIFO and Statistics Austria.

Significant deterioration in the macroeconomic environment

As the economic downturn is much more pronounced than projected in spring 2023, real GDP at the end of the forecast horizon in 2027 is estimated to be 3.3% lower than previously expected. The current WIFO forecast sees the Austrian economy in recession in 2023, with real GDP contracting by 0.8%. From 2024 onward, the economy is expected to recover. Average annual real GDP growth is projected to be 1.5% over the forecast horizon. The bleaker outlook will result in a deterioration in the fiscal balance by EUR 1.5 billion and EUR 5.4 billion in 2024 and 2027, respectively, according to the Fiscal Advisory Council. Economic activity is expected to be driven, among other things, by ongoing high energy prices and heightened inflation, which will move only gradually toward the ECB's medium-term inflation target of 2.0% by 2027.

Robust income growth supports fiscal path in 2023 despite recession

From a fiscal perspective, the current economic situation is more favorable than real GDP growth (which indicates a recession) would suggest. Nominal consumer spending (2023: +8.2%) and nominal wage settlements remain high and employment growth is robust (compensation of employees in 2023: +9.2%). This means that revenues from VAT and excise taxes as well as social security contributions and wage taxes continue to rise significantly in 2023 but the pace of growth will moderate in the subsequent years.

Fiscal burden of economic policy eases but remains high over the medium term

Crisis-related government measures continue to weigh on public finances in 2023. While in 2022, measures to tackle the repercussions of the COVID-19 pandemic accounted for the largest part of government support, in 2023, inflation compensation measures have a larger impact on the budget. By end-2024, almost all temporary crisis-related support measures will have expired. This improvement will to some extent be offset by newly adopted measures taking effect from 2024, in particular additional spending under the new fiscal sharing regime and measures under the government's 2023 "eco-social" tax reform. The remaining crisis-related support measures will expire in the years after 2024. In the medium term, the structural measures implemented since 2020 (especially those under the eco-social tax reform) and additional expenditure on defense, climate protection, long-term care and health care (also under the new fiscal sharing regime) contribute to economic policy measures becoming a considerably larger strain on public finances compared to pre-crisis 2019.

Table2: Budgetary impact of selected measures

Selected government measures (absolute budgetary impact in Bn EUR versus 2019*)	2022	2023	2024	2025	2026	2027
Economic stimulus and COVID-19 measures	-9.7	-3.4	-2.1	-1.4	-0.7	-0.4
Ecosocial tax reform	-3.1	-4.4	-5.9	-6.2	-6.0	-6.0
Inflation-relief measures	-7.7	-8.8	-2.1	-1.0	-1.0	-1.0
Energy crisis contribution electricity & fossil energy sources	0.0	0.3	0.0	0.0	0.0	0.0
Strategic gas reserve	-3.8	-0.1	-0.1	0.0	0.0	0.0
Defense budget increase	0.0	-0.2	-0.5	-0.9	-1.3	-1.5
Financial equalization mechanism 2024-2028	0.0	0.0	-0.7	-1.2	-1.7	-1.8
Other measures 2023	0.0	-0.2	-1.1	-1.2	-0.4	-0.4
Total	**-24.4**	**-16.8**	**-12.4**	**-12.0**	**-11.2**	**-11.1**
Total (in % of GDP)	**-5.4**	**-3.5**	**-2.5**	**-2.3**	**-2.0**	**-1.9**
of which: revenue side (in % of GDP)	-1.1	-1.5	-1.4	-1.3	-1.0	-0.9
of which: expenditure side (in % of GDP)	-4.4	-2.0	-1.1	-1.0	-1.0	-1.0

*) Negative values constitute a reduction of the budget surplus / increase of the deficit. The table only considers measures who exhibit budgetary effects in or after 2020.

Source: FISK estimates based on official budget documents (e.g. Wirkungsorientierte Folgenabschätzung (WFA)).

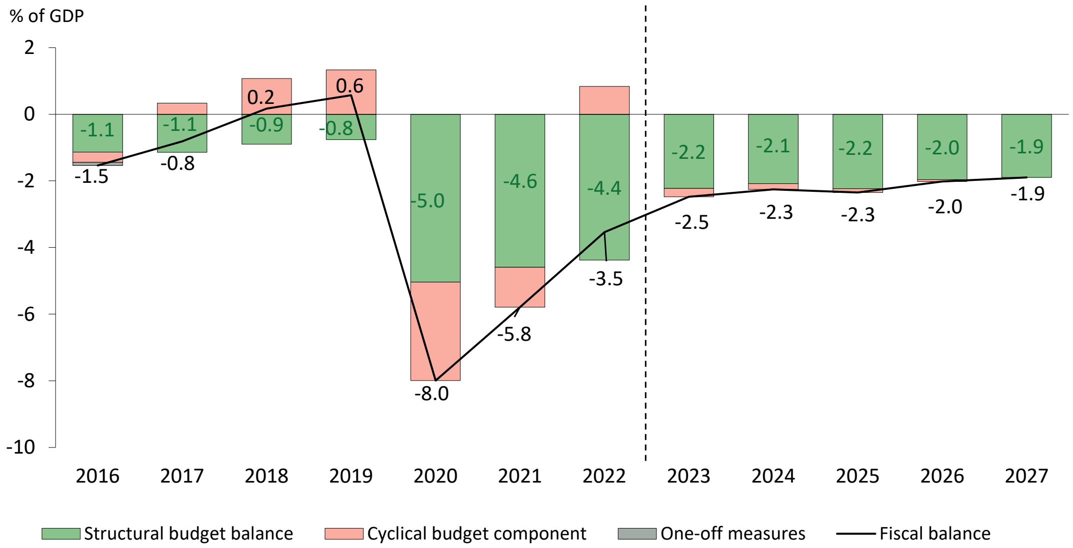
Demographic trend and unfunded expansionary economic policies will lead to high budget deficits in the medium term

The high inflation we have seen since end-2021 is alleviating the burden on public finances in the short run, but in combination with the associated increase in interest expenditure it will become an additional strain over the medium term (Box 1). Demographic aging is significantly driving up public spending on long-term care, health care and pensions. In addition, climate and environmental protection measures mean additional expenditure. As bracket creep has been eliminated, there are no automatic increases in tax revenues that would help fund additional expenditure. The government has not provided for measures that would finance demographically-induced increases in expenditure and additional economic stimulus. As economic growth remains subdued over the medium term, it will not contribute to easing budgetary pressures either. The full implementation of permanent measures under the eco-social tax reform will lead to a significant deterioration in the fiscal balance in the medium term.

Fiscal Advisory Council forecasts high structural budget deficits

The Fiscal Advisory Council expects high structural budget deficits over the entire forecast horizon. The output gap will be mildly negative in 2023 on account of the recession and will be closing by 2027.[1] As a result, the structural budget balance adjusted for the minor cyclical budget component is close to the fiscal balance. The structural budget balance remains clearly in negative territory in the medium term, reflecting the distinctly expansionary fiscal stance.

Chart 1: Austria's structural balance and its components from 2016 to 2027



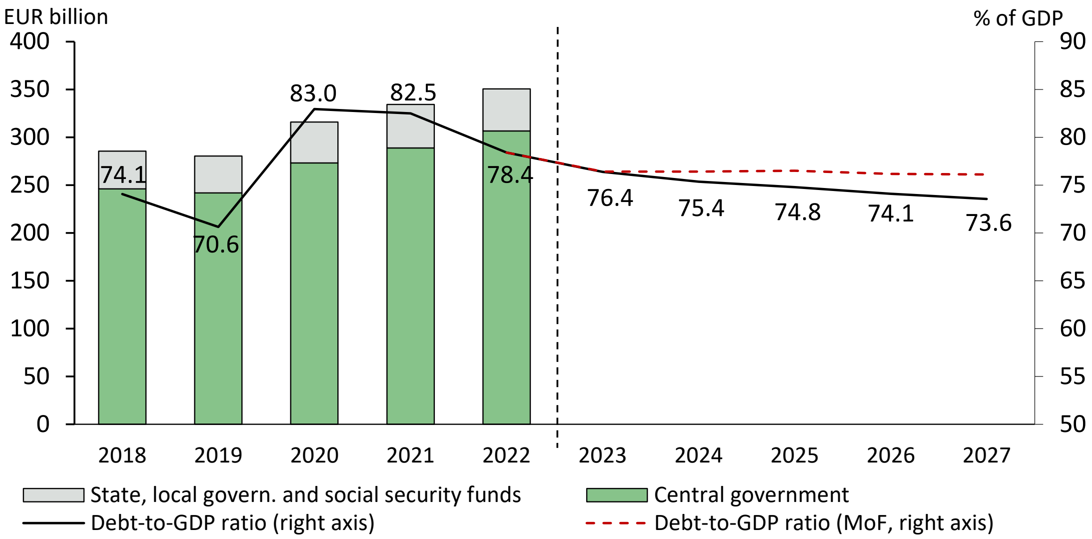
Sources: Statistics Austria, FISK autumn forecast 2023 and Draft Budgetary Plan 2024.

Debt ratio remains well above pre-crisis level in the medium term

The Fiscal Advisory Council projects public debt to drop to 76.4% of GDP in 2023 and to continue its decline to 73.6% of GDP by 2027. Despite this decrease, the debt ratio will remain clearly above the pre-crisis level recorded in 2019 (70.6%). The expected drop in the debt ratio is exclusively attributable to the continued inflation-related high nominal GDP growth rate (GDP denominator effect). The marked increase in interest payments and its associated contribution to debt, which will reach 1.6% by 2027, and high primary deficits over the medium term will prevent a stronger reduction in the debt ratio. The Ministry of Finance expects that, like the fiscal balance, the debt ratio will remain almost unchanged until 2027 despite strong nominal GDP growth.

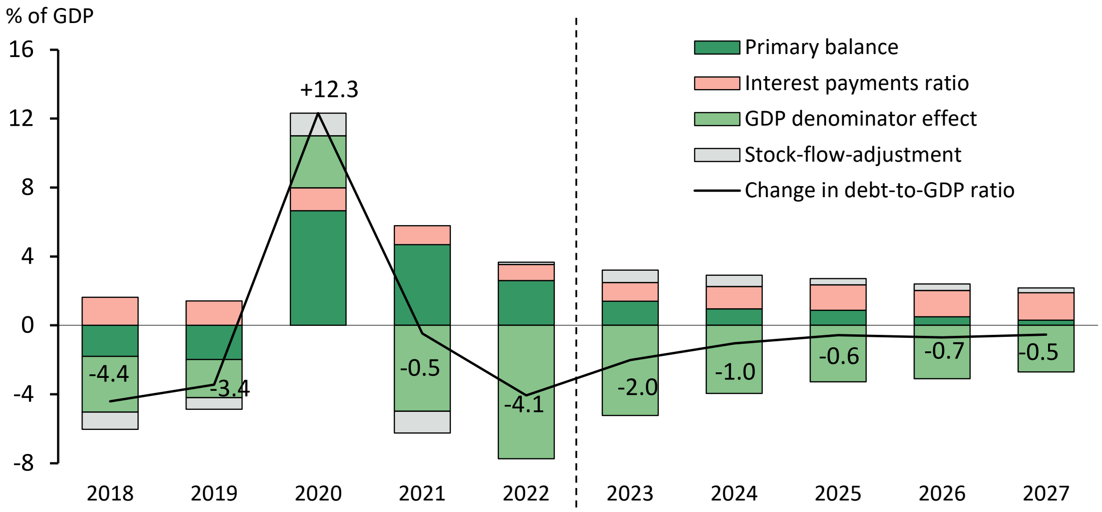
1 According to the European Commission's closing rule.

Chart 2: Austria's public debt (Maastricht definition) from 2018 to 2027



Source: Statistics Austria, FISK autumn forecast 2023 and Draft Budgetary Plan 2024.

Chart 3: Components contributing to changes in Austria's debt-to-GDP ratio*) from 2018 to 2027



*) - = reduction (+ = increase) of debt-to-GDP ratio.
Source: Statistics Austria, WIFO and FISK autumn forecast 2023.

Regime change after deactivation of general escape clause phase highlights breaches of structural budget targets from 2024

Based on a no-policy change assumption, we expect that in the short to medium term, Austria will be in compliance with the Maastricht deficit criterion. However, the projected deficits will remain at a high level of around 2% of GDP, which cannot be justified by current economic conditions. The Fiscal Advisory Council concludes in its fall forecast that Austria will significantly deviate from the EU structural budget requirements, which will apply again after the deactivation of the general escape clause from 2024 on. Neither will the structural budget deficit shrink to the required extent, nor will Austria meet the medium-term target of a structural budget deficit of no more than 0.5% of GDP within the forecast horizon. Moreover, from 2026, the slow reduction of the debt ratio will not comply with the applicable requirements of the Stability and Growth Pact.

That said, negotiations are currently underway at the EU level about a reform of the fiscal rules framework, which could already have an impact on the European Semester for fiscal policy coordination from 2024. The European Commission has proposed that in future, net primary expenditure be used as a new key indicator under the rules-based fiscal policy framework. Preliminary estimates suggest that Austria would be narrowly in compliance with this new upper threshold for the nominal increase in net primary expenditure in 2024.

Furthermore, until a new EU fiscal framework is finalized and comes into effect, Austria will have to examine to what extent the Austrian Stability Pact (ÖStP) could be sensibly applied and measures to correct previous breaches would be translated into the new context.

Box 1: Impact of a stylized 1% inflation shock on the fiscal balance

There are different ways in which inflation affects individual categories of government revenue and expenditure. Also, the impact of inflation depends on the characteristics of the inflation shock, which can vary in terms of type, size, evolution over time, feedback into the real economy etc. In the absence of a counterfactual macroeconomic assessment of the current situation ("What would Austria's macroeconomic situation look like without a sharp increase in inflation?"), this box examines – based on simplifying assumptions – what effects a stylized inflation shock would have on the Austrian economy. We simulate this shock using the Fiscal Advisory Council's fiscal forecasting model, assuming a permanent 1% increase in the price level by starting from the first year (2023), with WIFO's 2023 fall forecast serving as the baseline scenario. This means that the inflation rate in the first year is 1% above the baseline. In the subsequent years, the inflation rates correspond to those of the baseline scenario. It is assumed that the inflation shock is equally distributed across all groups of goods so that consumer prices increase in sync with the GDP deflator. We also assume constant shares in nominal GDP on the expenditure side and on the income side, but in the latter case only starting from the second year because wages and salaries increase nominally with a one-year lag. This implies that gross operating surpluses are disproportionately above the baseline by more than 1% in the first year. Other real effects, like changes in employment or real interest rates, are excluded by assumption. The nominal interest rate is therefore 1 percentage point above the baseline reference value in the first year to keep the real interest rate constant.

Many of these assumptions are not valid in the current high inflation period. The main purpose of this box is to demonstrate how sensitive the fiscal balance is to purely nominal changes in the macroeconomic base.

As wages and salaries rise with a lag, the increase in revenues in the first year is only half as high as in the second year. Revenues from social security contributions reflect this lag particularly well. The fact that income tax brackets are indexed to the consumer price inflation rate with a 1.5 year lag (while wages and salaries follow inflation with a one-year lag) generates a temporary increase in revenues reflected in direct taxes in 2024. In the medium term, a 1% increase in the price level translates into an increase in revenues by about EUR 2.6 billion.

Expenditure rises –by EUR 0.9 billion – at the time of the inflation shock primarily because of higher prices of intermediate consumption and higher interest expenses. By 2025, the increase in expenditure reaches EUR 2.7 billion. The reason for this big lag is that the indexation of cash welfare benefits is determined by the years t-2 and t-1. Owing to a large amount of government debt maturing in the second half of 2023, the rise in interest rates has the largest impact on interest expenditure in 2024. From 2025, the increase in interest expenditure slows down because of the full rollover of intra-year bonds affected by the interest rate rise.

Table3: Impact of a 1% permanent price shock from 2023 on

Categories	ESA-Code	2023	2024	2025	2026	2027
		EUR mill.				
Output	P1O	105	227	241	252	263
Taxes on production and imports	D2	471	624	654	684	710
Current taxes on income and wealth	D5	456	737	615	640	665
Social contributions and benefits	D6	96	736	798	831	862
Other revenue	-	74	99	100	104	107
Total revenue	**Sum**	**1,202**	**2,423**	**2,408**	**2,513**	**2,607**
Intermediate consumption	P2	322	335	345	353	361
Compensation of employees	D1	0	373	521	540	557
Subsidies	D3	0	59	60	61	63
Interest	D4	340	451	331	318	306
Social transfers other than in kind	D62	0	391	844	882	915
Social transfers in kind	D632	104	214	228	241	254
Gross capital formation	P5	145	151	156	160	163
Other expenditure	-	0	163	176	183	189
Total expenditure	**Sum**	**912**	**2,137**	**2,661**	**2,739**	**2,808**
Net lending / net borrowing		**290**	**286**	**-253**	**-226**	**-201**
Net lending / net borrowing (% of GDP)		0.08%	0.08%	-0.02%	-0.02%	-0.02%

Source: own calculation.

To sum up, following a 1% price shock in 2023, increases in government revenues are higher than increases in expenditure in the first two years; from the third year on, it is the other way round. As a result, the fiscal balance improves by just below 0.1% of GDP in each of the first two years, but deteriorates slightly over the medium term.