FISKALRAT
Austria

AUSTRIA'S FISCAL POSITION AND COMPLIANCE WITH EU FISCAL RULES

(EXTRACT FROM THE FISCAL RULES COMPLIANCE REPORT 2017–2022 BY THE FISCAL ADVISORY COUNCIL, MAY 2018)

The following chapter **compares** the **general government fiscal path defined in the current stability program with the Fiscal Advisory Council's budget forecast** including output gap calculations (Fiscal Advisory Council spring forecast) **for 2018 and 2019** and **evaluates** its **compliance with EU fiscal rules**. In its spring forecast, the Fiscal Advisory Council calculates the output gap used to cyclically adjust the budget balance according to the European Commission's methodology; the results thus attained correspond to those presented by the Austrian Institute of Economic Research (WIFO).

A summary of results including the Fiscal Advisory Council's recommendations and conclusions is provided in the **Executive Summary** of this report.

The Fiscal Advisory Council's current spring forecast takes into account all measures whose effects on public finances over time were adequately assessable (as at end-May 2018). These include in particular federal government **measures** taken **before fall 2017**, such as the 2015/16 tax reform, the 2015 labor market summit, the 2017/18 work program, the abolition of public long-term care providers' recourse to patients' assets, parliamentary bills of October 12, 2017, and **proactive measures** (e.g. broadband Internet projects), as well as **new measures** based on the **federal government's 2018/19 twin budget** such as cutting various state subsidy programs (i.a. "employment bonus" program, 50+ employment initiative, start-up package), extending the time horizon of investments by the Austrian Federal Railways and introducing a higher tax relief for families with children (Familienbonus Plus).

This chapter will not discuss the results of the **2012 Austrian Stability Pact** – an agreement between the federal, regional and local governments in accordance with Article 15a Federal Constitutional Law. Related assessments of compliance with **national fiscal rules** (for the federal government sector as well as for regional governments and local governments per province) can be found in **section 5.2** in the German version of this report.

Budget balance to improve further in 2018 and 2019: deficit clearly below Maastricht threshold of 3% of GDP

According to the **Fiscal Advisory Council's spring forecast**, the **general government budget balance** will contract to –0.2% of GDP in **2018** (from –0.7% of GDP in 2017) and will be slightly positive at 0.1% of GDP in **2019**. This expected **improvement** is mainly attributable to the following factors:

- the booming economy
- the scaling down of procyclical measures taken by the previous federal government (e.g. "employment bonus" program and investment premiums) and
- the low interest rate environment

The **general government budget balances** (**Maastricht** definition; as a percentage of GDP) forecast by the **Fiscal Advisory Council** will remain **clearly below the Maastricht deficit reference value** of 3% of GDP in 2018 and 2019. This is also in line with the forecast made by the federal government in its current stability program, which puts the budget balance at –0.4% of GDP (2018) and 0.0% of GDP

(2019), respectively. This means that Austria will **clearly comply** with the (nominal) **deficit rule** over the entire forecast horizon and **no excessive deficit procedure is likely to be launched** (table 1).

Table 1: Compliance with EU fiscal rules according to the Fiscal Advisory Council's 2018 spring forecast and the government's 2018 stability program

General government	EC 2017	FISK estimation 2017[1)]	2018	2019	MoF estimation 2017[2)]	2018	2019
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓
MTO (incl. eligible clauses)[3)]	✓	✓	✓	✓	✓	⊗	✓
Structural adjustment of deficit ratio[4)]	✓	✓	✓	✓	✓	⊗	✓
Government expenditure growth[5)]	⊗	✓	⊗	⊗	✓	⊗	⊗
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)							
Budget balance (Maastricht definition)	-0.7	-0.7	-0.2	0.1	-0.7	-0.4	0.0
Structural budget balance	-0.6	-0.5	-0.7	-0.4	-0.5	-0.9	-0.5
Structural budget balance incl. eligible clauses	-0.2	-0.1	-0.4	-0.3	-0.1	-0.5	-0.5
Total expenditure (nominal, adjusted, net of one-offs, change in %)	.	2.4	3.8	3.4	2.9	4.0	3.2
Gross debt (year-end figures)	78.4	78.4	74.3	70.7	78.1	74.5	70.9

Notes: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, ⊗... fiscal rule has not been met and significant deviation[6)]
EC - European Commission, FISK - Austrian Fiscal Advisory Council, MoF - Austrian Ministry of Finance, STAT - Austrian Statistics.

1) Preliminary data based on the budgetary notification (March 2018).
2) MoF estimation for 2017, as the stability program was already published in March 2018.
3) Eligible deviations, e.g. due to costs related to the arrival of refugees and anti-terrorism measures. When member States comply with their MTO no procedure will be triggered in case of noncompliance with the structural adjustment path or the expenditure rule.
4) Reduction of structural deficits depending on macroeconomic conditions, debt-to-GDP ratio and remaining structural adjustment required to achieve the MTO.
5) Medium-term rate of potential GDP growth including convergence margin, as long as MTO has not been achieved.
6) A deviation is deemed significant if the structural deficit deviates at least by 0.5% of GDP from the structural adjustment path or the MTO within one year or over two years (accumulated).

Source: STAT, MoF (Stability Program 2018), WIFO (Forecast, March 2018), EC (Spring Forecast, May 2018) and own calculations.

Austria will reach medium-term objective (MTO) in 2018 and 2019 (within margin of tolerance)

According to the **Fiscal Advisory Council's forecast**, Austria's structural deficit will increase from 0.5% of GDP in 2017 to **0.7% of GDP in 2018** before decreasing again to **0.4% of GDP in 2019**. Even if the flexibility clauses are not used, **Austria** will **reach its MTO** over the entire forecast horizon within the 0.25 percentage point **margin of tolerance** (which, in turn, would exclude the application of flexibility clauses according to the European Commission's established procedure). If the **additional costs** caused by the arrival of refugees (2015, 2016 and 2017) and those related to anti-terrorism measures (2016, 2017)[1] are **recognized**, as is permissible when assessing compliance with the fiscal rules, the structural deficit will amount to 0.4% of GDP in 2018 and 0.3% of GDP in 2019. This corresponds to an **overfulfillment of the MTO** (maximum deficit of 0.5% of GDP) in both years.

Since Austria will fulfill its MTO over the forecast horizon, **deviations from the requirement under the expenditure rule**, even if "significant," will **not trigger** an **early warning** by the **European Commission**. Decisions on whether to launch **significant deviation procedures** are taken by the Council

1 While the European Commission does not expect additional costs caused by anti-terrorism measures to increase further (as a percentage of GDP) in 2018 with reference to the government's stability program, it is likely to recognize such additional costs for 2017 in line with its current interpretation of the SGP.

of the European Union every spring, based on the **European Commission's overall assessment** using **realized data**.

For **2018, a deterioration of the structural deficit by 0.2% of GDP would still be in line with requirements** as the benchmark for the **permissible change in the structural balance** is derived from the gap between the **"frozen"** 2017 structural deficit and the MTO (using the more favorable value given for 2018 in the European Commission's 2017 spring or autumn forecasts)[2] and additional costs of 0.3% of GDP may again be deducted. The forecast **0.2% rise of the structural deficit in 2018** thus **complies with the structural requirement**. For **2019**, a **structural adjustment requirement of 0.3% of GDP** can be derived from the structural deficit forecast of 0.8% of GDP for 2018 made in the European Commission's 2018 spring forecast (deviation from the MTO: 0.3 percentage points) and the fact that the flexibility clauses will mostly cease to apply. According to the Fiscal Advisory Council's spring forecast, this requirement will be met in 2019.

In total, the **Fiscal Advisory Council's spring forecast** expects Austria to **meet its MTO and the structural adjustment requirement** in both **2018 and 2019** (unlike the federal government's current stability program, which expects noncompliance for 2018). The differences in the values for the 2018 structural deficit provided by the Fiscal Advisory Council's spring forecast and the government's stability program result exclusively from the Maastricht deficit; the underlying values for the output gap and one-off measures are identical in both forecasts.

Government expenditure to exceed threshold in 2018 and 2019, but breach is not "significant"

Annual growth of **nominal government expenditure (adjusted)**,[3] which is the applicable value for measuring compliance with the expenditure rule, will average 2.7% for the period from 2017 to 2019 according to the Fiscal Advisory Council's forecast, with growth rates ranging from 2.4% (2017) to 3.8% (2018) and 3.4% (2019). This will be due not only to **increased expenditure** but, in particular in 2019, also to a **decline in discretionary government revenues**, which affect aggregate expenditure.

Both the deviations from the MTO expected by the European Commission and the scope of eligible clauses play a role in determining the **expenditure benchmark**. Requirements under the expenditure rule (add-ons to, or deductions from, the reference rate for annual growth of public expenditure) will thus be somewhat less stringent for 2018 and stricter for 2019; according to the **current Fiscal Advisory Council's forecast, Austria will fail to comply with these requirements in both years.**[4]

Taking into account the applicable add-ons to or deductions from the reference rate for annual public expenditure growth, Austria will have to comply with the following **expenditure benchmarks**:[5]

- +2.9% in 2017 (taking into account a small add-on of 0.1 percentage points as the deviation from the 2016 MTO is slightly below the scope of eligible clauses),
- +3.3% in 2018 (taking into account an add-on of 0.5 percentage points as the deviation from the 2017 MTO is smaller than the scope of eligible clauses),

2 Since Austria had submitted its budget plan in the fall of 2017 under a no-policy-change assumption, "freezing" only became effective with the March 2018 update. In this context, the structural budget balance of 0.6% of GDP quoted in the European Commission's ad hoc forecast of April 2018 proved to be the more favorable value (and will thus continue to apply until the ex post assessment in spring 2019).

3 Aggregate expenditure does not include interest payments, cyclical spending on unemployment benefits and one-off measures. Additional discretionary revenues are subtracted; discretionary shortfalls in revenues are added.

4 As long as a Member State fails to comply with its MTO, its spending is constrained by country-specific expenditure benchmarks ensuring the required adjustment of the structural budget balance toward the MTO.

5 For details on how the expenditure benchmarks are set, see section 6.3 in the German version of this report.

- +3.0% in 2019 (taking into account a deduction of 0.6 percentage points resulting from the deviation from the 2018 MTO; eligible clauses will apply only marginally in 2019).

A comparison of the **growth rates of aggregate nominal expenditure (adjusted)** based on the **Fiscal Advisory Council's** current **spring forecast** with the **expenditure benchmarks** yields the following results:[6]

- In **2017,** the moderate **2.4%** increase of aggregate nominal expenditure was below the **benchmark.**

- The Fiscal Advisory Council's forecast expects a **3.8% rise in nominal expenditure** for **2018** (mainly stemming from expenditure categories that depend on inflation and from discretionary measures), i.e. a value exceeding the 3.3% benchmark. In this case, Austria will **fail to comply with the expenditure rule**. However, expenditure growth will **not** deviate **significantly** from the benchmark (EU definition).

- At 3.4%, growth of nominal government expenditure will **exceed** the 3.0% benchmark also **in 2019**. The resulting breach of the expenditure rule in 2019 is attributable i.a. to the loss of discretionary revenues (mainly resulting from the higher tax relief for families with children), which also has an expenditure-increasing effect because it is considered in the calculation of aggregate expenditure.

According to the Fiscal Advisory Council's current forecast, the **early warning mechanism (significant deviation procedure) will** most likely **not be triggered** as, from today's perspective, expenditure will not significantly exceed the benchmark and the MTO should be reached throughout the forecast horizon. This comprehensive view also relies on the results presented in the **federal government's current stability program.** The federal government's budget data confirm the **Fiscal Advisory Council's assessment** stating that in 2018 and 2019, **compliance with the EU expenditure rule will be Austria's main challenge.**

Austria set to comply with debt rule in 2018 and 2019

According to the **Fiscal Advisory Council's spring forecast**, Austria will meet all **three debt rule benchmarks** (i.e. the backward-looking, forward-looking and cyclically adjusted benchmark) **from 2017 onward.** Apart from the solid fiscal target, this development is primarily attributable to the winding down of assets held by state-owned bad banks and to the economic boom. The general government **debt path complies** with the **requirements under the EU debt rule,** according to both the **Fiscal Advisory Council's assessment** and the **federal government's current stability program**.

European Commission expects Austria to broadly fulfill structural budget requirements in 2018 and 2019

Based on its **2018 spring forecast** and in line with the current stability program and the Fiscal Advisory Council's 2018 spring forecast, the **European Commission** expects Austria's structural budget deficit to expand in 2018 and to shrink again in 2019 (2017: 0.6% of GDP; 2018: 0.8% of GDP; 2019: 0.6% of GDP). For 2018, the European Commission identifies a structural deficit ranging between the figures expected by the Federal Ministry of Finance and the Fiscal Advisory Council (0.9% and 0.7% of GDP, respectively). Factoring in extraordinary expenditures connected with the arrival of refugees and anti-terrorism measures – which will come to 0.3% of GDP in 2018 according to European Commission calculations – the **European Commission's spring forecast expects Austria to meet its MTO in 2018**. In **2019**, the structural deficit ratio will be within the **tolerance band** (even if the flexibility clauses are no longer considered), which means that Austria will again be able to **meet its MTO** (EU definition). With regard to the **expenditure rule**, the European Commission – in line with the current stability

6 The notable decline in interest payments does not have an expenditure-decreasing effect, as this expenditure category is not considered in the calculation of aggregate expenditure.

program and the Fiscal Advisory Council's current forecast – expects **noncompliance**; unlike the current stability program and the Fiscal Advisory Council's forecast, the European Commission expects "**significant**" noncompliance (EU definition, average deviation over two years) in **2019**. Moreover, the European Commission sees **risks to public finances** with regard to cost-cutting measures (in particular in public administration), which have not been fully specified so far. It also reiterates **calls** upon the Austrian government to adopt **measures** to strengthen the sustainability of the health care and pension systems and to streamline responsibilities and intergovernmental funding structures.