FISKALRAT
Austria

Recommendation of the Fiscal Advisory Council on Austria's budget policy and budget financing in 2015

Adopted at the Fiscal Advisory Council meeting on July 1, 2015

Economic environment

In its World Economic Outlook of spring 2015, the IMF expects a continued, albeit moderate recovery of global real GDP growth for 2015 (+3.5%) and 2016 (+3.8%), which is likely to be more pronounced in the industrialized countries than in the emerging economies. The improved growth outlook for the industrialized countries is attributable, inter alia, to real income growth in the oil-importing countries (caused by lower crude oil prices) and to exchange rate movements. The European Commission forecasts further economic growth of 1.5% in 2015 (2014: +0.9%) for the **euro area**, and a slight acceleration of growth to 1.9% in 2016. Private consumption will make the largest contribution to growth; export and import growth will be equally strong, which makes a contribution by net exports unlikely. GDP growth dynamics will be heterogeneous across the individual euro area countries. While Ireland and Spain are expected to post above-average growth rates, Italy and Finland will continue to record only weak growth over the forecast horizon. In 2015, average real GDP in the euro area will, for the first time, climb back to 2007 levels, with current economic performance above 2007 levels in ten euro area countries (including Austria, Germany and Ireland), while lagging behind those levels in the remaining nine euro area countries (including Greece, Italy, Cyprus and Spain).

Austrian economic growth, which came to +0.3% in 2014, is expected to continue at a slow pace in 2015 (+0.5% to +0.7%)[1]. **Gross fixed capital formation** is stagnating and is, yet again, not expected to contribute to growth, with investment volumes continuing at below-2007 levels. Weak total **domestic demand** and subdued corporate sector expectations offset positive stimuli from the international environment (lower oil price, euro depreciation and ECB asset purchase program). Economic activity in Austria is expected to pick up only in 2016, with GDP growth projected to reach between 1.3% and 1.9%. The rather broad range of the 2016 growth outlook results mainly from different assumptions regarding the extent of the planned compensatory measures of the 2015/16 **tax reform** (fighting tax and social fraud, administrative reforms, cuts in subsidies) and the resulting economic effects. In 2015, Austrian economic growth will be stimulated above all by domestic demand. Moreover, exports are set to be considerably more dynamic than in 2015.

Given weak economic activity and low energy prices, **HICP inflation** in Austria is forecast to range from 0.9% to 1.2% in 2015, down from 1.5% in 2014. The European Commission expects euro area inflation to average out at 0.2% in 2015, which would mean that the inflation differential between Austria and the euro area will continue to amount to at least 0.7 percentage points. Price developments in Austria differ from those in the euro area in particular in the services sector, with hotel and restaurant services, health services and rental price dynamics playing a key role. In 2016, the dampening effect of energy prices is expected to discontinue, and economic recovery will drive up the inflation rate to between 1.7% and 2.0% in Austria.

Employment growth in 2015 will be comparatively low (0.6%) amid weak economic activity, and also for 2016, growth is not expected to exceed 0.7%.[2] With labor supply continuing to rise strongly, the **unemployment rate** will climb to 5.7% in 2015 and to 5.8% in 2016 (of the total labor force; Eu-

1 June 2015 data of the Austrian economic research institutions WIFO and IHS as well as of the OeNB.
2 Rise in payroll employment according to WIFO, June 2015.

rostat definition). According to the national definition (percentage of all persons in payroll employment), the unemployment rate in Austria will come to 9.3% in 2015 and to 9.6% in 2016.[3]

EU requirements and Austria's budget path (as set out in the Austrian Stability Pact)

Since the **excessive deficit procedure** (corrective arm) was **closed** in 2014, Austria has been subject to the provisions of the **preventive arm** of the Stability and Growth Pact (SGP), which generally stipulate the following (in the absence of a derogation):

- The general government deficit is to be kept below the **Maastricht threshold** of 3% of GDP.
- The **structural budget balance is to be adjusted** toward the medium-term objective (MTO) of –0.45% of GDP. **Compliance with the MTO** is mandatory also in 2015.
- The **MTO** is deemed fulfilled if the structural budget balance is within a **margin of tolerance** of 0.25 percentage points around the country-specific MTO.
- **Annual (real-term) general government expenditure growth** is to be limited (excluding inter alia interest payments and non-discretionary changes in unemployment benefit expenditure) to the reference medium-term rate of potential output growth, unless the excess is matched by discretionary revenue measures. As long as Austria does not reach its MTO, it must reduce expenditure growth more strongly. For 2015, the (adjusted) upper limit for year-on-year real-term expenditure growth is 1.3% according to the European Commission.
- **The government debt ratio is to be reduced** in line with the debt rule during the **transition period** (2014 to 2016), which according to the European Commission would allow for a deterioration of the structural budget balance by 0.4% of GDP without violating the debt rule.

Given that Austria has **achieved its MTO in 2014 and thus ahead of schedule**, the **updated Austrian stability program** of the federal government (April 2015) essentially provides for maintaining a **structural budget deficit of around 0.5% of GDP.** After coming to 2.4% of GDP in 2014, the **general government budget deficit (Maastricht definition)** should go down to 2.2% of GDP in 2015 (Fiscal Advisory Council forecast: 1.8% of GDP) and gradually decline to 0.5% of GDP in the following years due to an improvement of the economic environment and the phaseout of bank support measures. This budget path takes into account the **2015/16 tax reform**, which provides for relieving the tax burden on labor by around EUR 5 billion and for predominantly revenue-side compensatory measures. The **general government debt ratio** will increase again in 2015, namely to 86.8% of GDP in 2015 (2014: 84.5% of GDP) according to the Austrian stability program. This rise is mainly due to the transfer of liabilities of Kommunalkredit Austria AG to the state-owned wind-down unit KA Finanz AG (around EUR 6 billion).

The **Council of the European Union** concluded in June 2015 that while Austria had reached its budget MTO in 2014, it is set to deviate again from the MTO in **2015** and runs the risk of a **significant deviation from the MTO** in **2016**. This Council estimation regarding Austria's future budget path is **similar to Fiscal Advisory Council findings** (see Fiscal rules compliance report 2014 to 2019). **According to the Fiscal Advisory Council**, structural budgetary shortfalls – at least for the first few years – are to be expected from the 2015/16 tax reform, which has now been largely finalized. Moreover, major uncertainties persist about the extent of the effects to be expected for the budget from the resolution of Hypo Alpe-Adria-Bank.

3 Source: Austrian Institute of Economic Research (WIFO), June 2015.

Recommendations of the Fiscal Advisory Council[4]

Against the background of the current public finances situation, the fiscal requirements based on EU legislation and the anticipated economic environment, the **Fiscal Advisory Council issues the following recommendations for 2015 and for the medium-term budget path**:

Budget path, fiscal rules and 2012 Austrian Stability Pact

- The federal government and the regional and local governments should continue to be **strictly obliged to comply with the EU fiscal rules** and to take **timely measures to counteract any deviation** if necessary. Austria has reached its nationally defined budgetary target or MTO of –0.45% of GDP ahead of schedule (namely in 2014). The Fiscal Advisory Council cannot rule out, however, that Austria might again deviate slightly from its MTO in 2015. In 2016, net revenues are set to decline as a consequence of the 2015/16 tax reform, relieving the tax burden on labor; this will interrupt the consolidation path and, according to the Fiscal Advisory Council estimate of May 2015, result in a significant deviation from EU fiscal rules. The new "margin of tolerance," allowing a deviation from the MTO of 0.25% of GDP (ex post), should not be automatically taken into account at the budget planning stage. Even a minor transgression of this margin of tolerance in two consecutive years would lead to a **significant deviation**, triggering procedural steps under the SGP.

- The **correction mechanism** laid down in the **2012 Austrian Stability Pact** and to be activated automatically if significant deviations from the MTO or from the adjustment path toward the MTO occur should be aligned with the current **EU requirements** (Fiscal Compact, Article 3 paragraphs 1e and 2) and the **time schedule of the correction procedure** should be tightened considerably:

    - The **2012 Austrian Stability Pact** lays down **threshold values** for the control accounts that are kept to capture deviations from the respective **requirements for the structural budget balance** of the federal, regional and local authorities (federal government: -1.25% of GDP; regional and local governments: -0.367% of GDP); these threshold values at the general government level are clearly higher than the **EU's definition of significant deviations** (0.5% of GDP) and must therefore be reduced.

    - In case of noncompliance with the targets that trigger the correction mechanism, the **correction schedule**, which is to be agreed upon by the respective regional or local authority and the mediation panel, should be automatically linked to the **budgeting process** for the following year to ensure that correction measures – unless exceptional circumstances apply – take effect as quickly as possible.

    - The Fiscal Advisory Council's recommendations regarding the activation, extension or termination of the **correction mechanism** (Article 1 paragraph 1 no 6d, 2013 Fiscal Advisory Act) should be strengthened, in line with international practice, according to the **comply or explain principle** and the dialog between the parties involved should be intensified.

- The **complexity of the national fiscal rules** laid down in the **2012 Austrian Stability Pact** at the level of the regional or local authorities should be reduced to the extent possible under the EU fiscal rules. The current requirements to break down the EU's fiscal requirements for the general government to the level of regional and local governments entail costly methodological and operational challenges. Instead, simpler requirements could be defined for the **regional level** which would also ensure solid budgeting in accordance with EU requirements.

---

4 These recommendations were adopted in a consensual manner by the 12 members with voting rights. Specific parts were adopted by majority decision: third recommendation (6 consenting votes / 5 dissenting votes / 1 abstention), fifth recommendation, last item (1 abstention), and sixth recommendation, sixth item (7 consenting votes / 5 dissenting votes).

Transparency, budget rules, contingent liabilities

- Obstacles (laws, regulations, terms and conditions) that prevent the **publication and dissemination of documents on budget and debt developments** should be eliminated provided there are no **specific legitimate interests** to the contrary. The current practice of generally classifying mandatory reports delivered by the executive branch to the legislative branch (National Council, provincial parliaments) secret renders the continuous evaluation of Austria's budget developments difficult – both in general and for the Fiscal Advisory Council. A case in point are the **reports submitted under the Federal Budget Act 2013** to the Parliamentary Budget and Finance Commission. The **Fiscal Advisory Council's** statutory **right to information** should be interpreted in such a way that it includes information submitted by the ministries to the Parliamentary Budget and Finance Commission.

- **Explicit and implicit contingent liabilities** should be contained by applying unambiguous **legal standards, risk management** methods and **transparency**. The following measures would be advisable:

    - introducing strict caps for guarantees provided by the individual central, regional or local authorities according to uniform criteria, which should at any rate consider the sustainability of particular authorities. The current caps for guarantees are too high, as a rule, and can be changed anytime. In addition, economic viability **criteria for evaluating the assumption of liability** should be developed.

    - Possible misaligned incentives for **federal government financing provided to third parties** and/or **government guarantees** should be avoided by introducing risk-adequate surcharges or discounts for financing costs and/or guarantee premiums. Using **uniform and objective criteria** for calculating the **risk component** (which should ideally be evaluated externally) for all federal, regional and local authorities would be advisable.

    - **Clear and uniform budgeting and accounting rules** for all federal, regional and local authorities should be introduced and the intended adjustment of the **Budgeting and Accounts Regulation to the central government's budget standards** should be implemented.

    - A legislative framework for the **clarification of liability relationships** between the federal government and the regional authorities should be adopted and **procedural rules** for dealing with **imminent insolvency** should be introduced. Assumptions on supposed (implicit) federal government guarantees contribute to misaligned incentives and have the potential to trigger unintended market reactions. Currently, there are no legal provisions for such cases that apply to the regional level.

    - Stringent and clear legal standards for (exclusively low-risk) investment and financing transactions (**prohibition of speculation**) should be introduced. Foreign currency positions, derivatives and other risky positions should be made subject to **professional risk management**. If such positions are very high, the federal, regional and local authorities should develop and disclose a **strategy for the reduction of these positions**.

    - The target range of the interest-fixing period for the financial liabilities portfolio should be extended upward (taking into account the time structure of repayments) given the **historically low interest rate level** and the flat yield curve.

Structural reforms, fiscal sharing and fiscal connection

- The Fiscal Advisory Council maintains that the **reform framework of the new fiscal sharing arrangements** should be based on the following principles:

    - carrying out a **preliminary critical revision of tasks** as part of the negotiations on the

new fiscal sharing arrangements;

- increasing transparency and reducing the number and complexity of flows funds (intergovernmental transfers) and their use;
- implementing **outcome-oriented control** and **monitoring** measures;
- strengthening the principles of **fiscal connection** (consolidating the responsibilities for tasks, expenditures and financing);
- reinforcing **direct responsibility** by reducing mixed financing;
- examining individual taxes with a view to their suitability to **increase economic efficiency**;
- providing for task-oriented funding in core areas, thus ensuring an equalization of burdens in demographic, topographic and locational terms, while at the same time drastically reducing the complexity of **primary distribution** of shared funds (e.g. replacing the many different individual rules on the compensation of partial income shortfalls by one simple key);
- considering the **fiscal performance capacity** of the federal, regional and local authorities, e.g. by an **equalization of resources** for structurally weak regions.

- Hedging the **long-term sustainability** of public finances and the **scope for immaterial and material public investment**.
- Continuing **structural reforms** in particular in **aging-related areas** (pensions, long-term care, health), in the area of **installing administrative federalism** and in the field of **subsidies**. Without structural measures, financing gaps will widen continuously.