AUSTRIA’S FISCAL POSITION AND COMPLIANCE WITH EU FISCAL RULES

(EXTRACT FROM THE FISCAL ADVISORY COUNCIL’S FISCAL RULES COMPLIANCE REPORT 2019–2021 FOR AUSTRIA, MAY 2020)

In this section, we evaluate the general government's fiscal path defined in Austria's current stability programme and compare it with the Fiscal Advisory Council’s budget forecast for 2019 to 2021, with a view to assessing Austria’s compliance with EU fiscal rules.

Given the heightened uncertainty about the future course of the COVID-19 pandemic and the fiscal implications of the macroeconomic shock and of support measures, the projected **fiscal path** is also surrounded by particularly **high uncertainty**. For this reason, our focus is on the years 2019 and 2020.

We will not discuss the results related to the **2012 Austrian Stability Pact**, which is an agreement between the central, regional and local governments in accordance with Article 15a Federal Constitutional Law. We assess compliance with national fiscal rules (for the central government sector as well as for regional governments and local governments in each province) in section 5 of the German version of the Fiscal Rules Compliance Report.

Considerable deterioration in 2020 budget balance and debt ratio because of COVID-19

The **budget balance (Maastricht definition)**, which was +0.7% of GDP in 2019, is expected to deteriorate dramatically in 2020. The COVID-19 pandemic has caused a severe slump in economic activity and made the government adopt far-reaching support measures. Overall, the Fiscal Advisory Council expects the budget balance to worsen by 10.3 percentage points to –9.4 % of GDP in 2020. However, as the domestic economy is expected to see a swift recovery, we project that the budget deficit will shrink to 3.0% of GDP already in 2021.

While Austria stayed clearly below the deficit benchmark of 3% of GDP in 2019, the COVID-19 response will trigger a significant breach of the deficit criterion in 2020. As a result, the European Commission prepared a **report in accordance with Article 126 (3) Treaty on the Functioning of the European Union**. The report encompasses an in-depth analysis and an assessment whether an excessive deficit procedure (EDP) shall be opened. Given the clear breach of the deficit criterion, starting an EDP seemed justified and likely, regardless of the temporary nature of the deviation and that it had been caused by an exceptional event. However, the European Commission identified other “relevant factors” that prevented the opening of an EDP. It considered that the measures the Austrian government adopted to mitigate the economic impact of COVID-19, which are the main cause of the breach of the deficit criterion, are a contribution to the EU’s coordinated response to the pandemic. The Fiscal Advisory Council’s budget forecast predicts that Austria will slightly exceed the 3% deficit benchmark also in 2021. That said, even small data revisions may alter this assessment. Based on the current stability programme, both the European Commission and the federal government expect that Austria will manage to remain below the deficit benchmark already in 2021.

According to the Fiscal Advisory Council’s spring forecast, Austria met both the backward-looking and the cyclically-adjusted benchmark of the **debt rule** in 2019. For 2020, we expect that Austria will not meet any of the three debt rule benchmarks due to the sharp increase of the debt ratio. This assessment is in line with the figures provided in the federal government's stability programme and the European Commission's assessment. Our calculations suggest that Austria will fail to comply with the debt rule also in 2021; these calculations take into account estimates of potential output growth which, in our opinion, should not be used for interpreting Austria's fiscal path, however. Hence, the general government debt path would not be in compliance with the EU debt rule. By comparison, the European Commission expects Austria to meet the cyclically-adjusted debt rule already in 2021. This assessment is based on potential output growth estimates that have been adjusted for the impact of the COVID-19 crisis (section 4.2).[1] In contrast to an EDP initiated because of noncompliance with the deficit criterion, an EDP for a breach of the debt rule can be opened only on the basis of actual outcomes. In other words, an EDP for noncompliance in 2020 can be started in spring 2021 at the earliest.

Activation of the general escape clause allows deviation from structural budgetary objectives of the SGP

The sharp decline in real GDP in 2020 owing to the economic impact of the COVID-19 pandemic has led to an implausible downward revision of potential output and, hence, to an ex post deterioration in the 2019 **structural budget balance**. The Fiscal Advisory Council expects Austria to deviate from its medium-term objective (MTO) in 2019. This forecast is based on current potential output estimate we used in our forecast, which has not yet been adjusted for plausibility considerations with a view to COVID-19. By contrast, the European Commission, whose assessment takes into account plausibility checks, still assumes that Austria will be in compliance with the MTO in 2019. The consequences of a breach of the expenditure rule depend on which of these two assessments will turn out to match actual outcomes: If Austria meets the MTO, deviations from the expenditure rule will not trigger an early warning by the European Commission, even if such deviations are "significant."

Table 1: Austria's fiscal position in relation to the EU fiscal rules

	European Commission estimate			Fiscal Advisory Council estimate			Federal Ministry of Finance estimate		
Staat insgesamt	**2019**	**2020**	**2021**	**2019**	**2020**	**2021**	**2019**	**2020**	**2021**
Maastricht deficit of no more than 3% of GDP	✓	⊗	✓	✓	⊗	⊗	✓	⊗	✓
MTO of no more than -0,5% of GDP[1)]	✓	**general escape clause**		⊗	**general escape clause**		⊗	**general escape clause**	
Government expenditure growth	⊗ [2)]			⊗			⊗		
Reduction of debt ratio	✓	⊗	✓	✓	⊗	⊗	✓	⊗	✓
Austrian general government fiscal indicators (% of GDP)									
Budget balance (Maastricht definition)	0.7	-6.1	-1.9	0.7	-9.4	-3.0	0.7	-8.0	-1.9
Structural budget balance[1)]	-0.3	**general escape clause**		-0.8	**general escape clause**		-0.8	**general escape clause**	
Total expenditure (nominal, adjusted, net of one-offs, change in %)	.			**3.8**			**3.7**		
Gross debt (year-end figures)	70.4	78.8	75.8	70.4	82.4	81.8	70.4	81.4	79.3

Legend: ✓ ... compliant with fiscal rule, ⊗ ... not compliant with fiscal rule, ⊗ ... not compliant with fiscal rule + significant deviation[3)]

1) 2019 incl. eligible deviations under unusual event clause, e.g. costs related to refugees. Red figures apply under the regular approach for estimating potential output rather than the modified methodology used temporarily by the European Commission.

2) A deviation from the expenditure benchmark is not considered significant if the Member State concerned has overachieved the MTO.

3) 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 cumulated over two years.

Source: Fiscal Advisory Council (Forecast, May 2020), European Commission (Forecast, May 2020), Ministry of Finance (Stability Programme 2020), WIFO (Forecast, March 2020), authors' calculations.

1 The calculation of the cyclically-adjusted benchmark takes into account a lower growth rate of potential output compared to the European Commission.

According to the Fiscal Advisory Council's spring forecast, which sees a **nominal increase in (adjusted) total spending** of 3.8% in 2019, Austria is set to exceed the 3.2% expenditure benchmark by 0.6 percentage points. Furthermore, if we look at the two-year horizon, that is, the average increase of expenditure in 2018 and 2019, Austria will breach the significance threshold as defined by the EU, which is in line with the European Commission's assessment.[2]

The **general escape clause** has been activated for **2020 and 2021** (see section 3.2). Therefore, there will be no numerical analysis of the fiscal position with a view to its compliance with the structural fiscal rules (structural budget balance, expenditure rule).

In sum, the analysis based on the Fiscal Advisory Council's forecast points to deviations from the structural budgetary objectives (MTO, expenditure growth). However, the European Commission takes action only on the basis of its own calculations and data. Since the spring economic outlook published by the European Commission, which was based on a modified calculation of potential output, found Austria in compliance with its MTO requirement, the breaches of the expenditure rule identified for 2019 remain without consequence and no early warning mechanism ("significant deviation procedure") has been triggered.[3] Deviations from the structural budget requirements in 2020 and 2021 will not be sanctioned because the general escape clause of the Stability and Growth Pact has been activated in view of the COVID-19 pandemic. In its **country-specific recommendations** of May 2020,[4] the European Commission explicitly called upon Austria to take all the necessary measures to combat the COVID-19 pandemic and support economic activity throughout the crisis and the ensuing recovery. However, as soon as macroeconomic conditions allow, the fiscal path must be adjusted to accommodate both a sound fiscal position and debt sustainability in the medium term and support investment activity.

2 A deviation from the requirement or the MTO is considered to be significant if it amounts to 0.5 percentage points in a one-year assessment or in a cumulative two-year assessment.

3 https://ec.europa.eu/info/sites/info/files/economy-finance/at_sp_assessment_2020.pdf

4 https://ec.europa.eu/info/sites/info/files/2020-european-semester-csr-comm-recommendation-austria_en.pdf