# Recommendations by the Fiscal Advisory Council on Austria's budget policy for 2023

## To open up fiscal space in the medium term, expansionary fiscal policy needs to be tightened again while considering the business cycle

**Background:** Austria's fiscal space will be narrowing over the short to medium term because the economic environment is deteriorating and because the pandemic and high inflation have made it necessary to adopt temporary discretionary support measures designed to mitigate the consequences of these multiple crises for households and businesses. What is more, demographic change, low real economic growth and rising interest expenses are increasingly putting strain on public finances over the medium term. This will result in deficits, some of them substantial, which will amount to over 2% of GDP in the medium term according to the Fiscal Advisory Council's fall forecast. Austria's debt ratio, which has been strongly elevated because of crisis measures, is moderating against the background of high nominal economic growth driven by inflation. It will, however, remain clearly above the Maastricht ceiling of 60% of GDP and above pre-crisis levels, reaching 72.6% of GDP in 2026 (2019: 70.6% of GDP).

**Recommendations:**

- To regain some fiscal space, it is crucial that expansionary fiscal policy be tightened again taking into account the business cycle and that temporary support measures be phased out as planned. In the view of the Fiscal Advisory Council, the medium-term budgetary objectives the federal government has set out in its fiscal strategy report cannot be reached without additional measures. The federal government should therefore present a holistic concept for the long-term stabilization of public finances, which needs to include ways to fund crisis measures.
- Where temporary support is granted to mitigate the effects of inflation, policymakers need to keep in mind that this is merely an interim option to bridge financing gaps until real purchasing power is restored through the usual mechanisms (e.g. wage increases, indexation of social benefits). The current inflation shock does not seem to necessitate additional general measures, especially for households, as automatic indexation will be higher than inflation from 2023 and 2024 onward. Some groups that are particularly affected and at risk of poverty may, however, need increased and better targeted support measures.
- A scientific evaluation of how effective, targeted and adequate revenue- and expenditure-side support measures are (in terms of addressing the underlying shock) should contribute to an effective and targeted use of public funds. Such an evaluation, which is seen as a prerequisite and basis for deciding on any new measures, would require the creation of an adequate data basis at household level.
- Also, the government should pay closer attention to the interplay between monetary and fiscal policy in order to minimize (1) avoidable counterproductive effects the fiscal expansion might have on the ECB's monetary policy objectives and (2) counterproductive effects the monetary policy tightening might have on fiscal targets.

## Investments in the future and structural reforms to safeguard long-term fiscal sustainability

**Background:** Our fiscal sustainability report of September 2021 found that government expenditure on health and long-term care services is set to increase particularly strongly in the long run, namely from 7.1% and 1.2% of GDP in 2019 to 9.9% and 3.1% of GDP in 2070. The comparatively moderate growth of pension expenditure (from 14.0% of GDP to 15.2% of GDP in the same period) is affecting the replacement rate of pension payouts and is very sensitive in view of the extraordinary increases in pension payouts repeatedly recorded in the past. In light of the permanent effects of the current fiscal policy (inflation indexation of the Austrian Income Tax Act, value adjustment of social benefits), the findings of the Fiscal Advisory Council's fiscal sustainability report regarding the long-term sustainability gap remain virtually unchanged. We had already by default factored in an acceleration of revenue and expenditure growth in the long-term projections.

Investment and structural reform can contribute to sustainable economic growth and hence strengthen fiscal sustainability. Inaction in addressing climate change, on the other hand, will clearly drive up follow-up costs. Ensuring fiscal sustainability does not preclude visible progress toward a green, digital, inclusive and resilient economy. The Fiscal Advisory Council therefore welcomes initiatives such as the federal government's climate and green transition initiative and the Municipal Investment Act 2023.

Recommendations:

- The green and digital transformation should be actively and resolutely supported with a balanced mix of measures (e.g. regulatory and fiscal measures) which provide incentives for private and public investment. This mix should include implementing a targeted education and qualification initiative to address both upskilling (e.g. innovation capacity, entrepreneurship, relevant vocational training, green and digital qualifications) and the imminent acute shortage of skilled labor.

- To allow an efficient use of resources for climate protection, policymakers should:

    - gather all the pertinent facts (defined target path, identification of the investment gap, marginal abatement cost curve);
    - evaluate the cost effectiveness of individual technologies;
    - establish an overall strategy by involving the social partners and improving coordination across the different levels of government with a view to implementing a balanced mix of measures and incentives;
    - undertake some reallocation within the budget to find necessary budget funds;
    - coordinate efforts toward a green and sustainable orientation of public finances.

- Structural reforms need to be implemented to put a brake on spending growth. Above all, efficiency gains need to be generated, in particular by disentangling responsibilities and financing across different levels of government. Also, to preserve sustainable financing for the pension system, the government should refrain from making extraordinary adjustments to pensions.

- Increasing the frequency of general government spending reviews, especially in the areas of health, long-term care, subsidization, climate policy and education, could raise transparency and help identify both issues that require action and options for addressing them.

## Results-oriented, swift negotiations on the revenue sharing agreement are an opportunity to establish strengthened coordination and steering mechanisms across all levels of government

**Background:** Funding for regional and local governments is largely dependent on financing flows across the different levels of government. These financing flows, in turn, depend strongly on the institutional and legal situation within the Republic of Austria (division of responsibilities, tax powers, revenue sharing rules). The Revenue Sharing Act (Finanzausgleichsgesetz – FAG) 2017–2021, which will remain in force for two additional years, will continue to provide the financial framework for the different levels of government in 2023. The revenue sharing agreement decided on at the time also contained elements that were designed to trigger structural reforms. Steps to prepare a federal state reform, a benchmarking model for assessing efficiency in areas within public responsibility or the reform of the property tax were agreed. Moreover, it was agreed to promote a more task-based allocation of funding in the Revenue Sharing Act on the basis of pilot projects (e.g. in the area of elementary and lower secondary education).

Although first steps toward disentangling competencies have been taken, important areas like the hospital and education sectors have yet to be addressed. From the Fiscal Advisory Council's perspective, the government has to date failed to implement important structural reforms: aligning responsibilities with the power to tax and the power to spend, establishing fiscal equivalence (beneficiaries of a public good are responsible for financing this public good) and promoting a more task-based allocation of funding.

**Recommendations:**

- The negotiations on the new revenue sharing agreement should be conducted swiftly and focus on results, in particular with regard to raising transparency, efficiency, coordination and steering within a federal state. These results need to include the following:
    - disentangling financing flows and tasks across the different levels of government;
    - promoting a more task-based allocation of funding, especially for social transfers in kind (e.g. child care, long-term care);
    - strengthening the regional and local governments' tax autonomy and thus their responsibility for financing public services subject to a reform of tasks;
    - establishing a mechanism for distributing and financing the fiscal burden or "investment gap" arising from the green and digital transformation;
    - developing benchmarks.
- An overall subsidization strategy for the general government needs to be established. Above all, Austria needs to avoid unintentional multiple subsidies through different levels of government and conflicting incentives of measures – both in terms of the measures as such and the interplay of different levels of government (e.g. electricity price cap). The following aspects are of particular importance:
    - design of subsidies: subsidies need to effectively target those who really need them
    - transparency database: identifying potential for further development; data analysis and conclusions based thereon

## Institutional mechanisms for raising the transparency, effectiveness and impact orientation of budgets

**Background:** Over the last few years, the federal government has introduced several mechanisms to manage its budgets in a more transparent and effective manner, focusing on both targets and impacts: impact orientation within the framework of the 2009 reform of the legal framework for budgeting, including gender budgeting, spending reviews and, most recently, green budgeting. These mechanisms are meant to improve fiscal policy by paying closer attention to the intended and achieved impact of measures rather than focusing primarily on the input side. Applying such mechanisms can raise the transparency and effectiveness of the budget process and the accountability of political decision-makers. Currently, however, the government is not making use of the full benefits these mechanisms potentially afford.

**Recommendations:**

- Mechanisms to raise the transparency, effectiveness and impact orientation of budget management should be coordinated more effectively across ministries and different levels of government.
- The individual mechanisms must be brought into closer alignment to avoid uncoordinated and inefficient parallel structures, overlap and redundancies.
- The quality of the impact assessment within the framework of the regulatory impact assessment for draft legislation and of the compulsory ex post evaluation must be safeguarded and developed further.

- It should be possible to make better use of the potential offered by gender budgeting by more closely considering relevant operational targets as well as suitable measures and by ensuring better coordination across different ministries.

## New spending rule in line with the European Commission's proposal should be implemented constructively and quickly; structural budget balance should be retained as a key figure for orientation and analysis

**Background:** Based on the European Commission's first initiative of February 2020 to reform the Stability and Growth Pact, which has been discussed with national institutions, stakeholders and EU institutions in the meantime, the European Commission submitted a new proposal in November 2022. The most important elements of the current reform proposal are simplifying the fiscal rules and promoting more fiscal rules ownership at the level of the individual member states. 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. Fiscal structure plans are supposed to offer more flexibility for growth-enhancing reforms and investments, especially in the area of green and digital transformation. A more realistic, slower debt reduction is to be backed by a stronger sanctioning mechanism. Based on the proposal, the structural budget balance, which has served as a key figure for fiscal policy orientation and analysis in the past, will no longer be considered. The proposal increases the European Commission's discretion in determining the reference path and in assessing and recognizing reforms and investments. It also opens up some room for negotiation between the European Commission and member states regarding the final adjustment path. The proposal is rather vague and non-committal regarding the role of independent fiscal institutions (IFIs).

Recommendations:

- Austria's federal government should actively and constructively contribute to ensuring that the process of reforming the EU fiscal framework is swiftly brought to a conclusion – in the current phase in which the general escape clause still applies – which will pave the way for making the necessary adjustments to the national fiscal framework. Speedy decisions toward simplifying the framework and laying down country-specific, steering-relevant rules are a cornerstone for sustainable fiscal policy and adequate surveillance.

- 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. This does 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.

- The Fiscal Advisory Council supports the idea of stronger coordination across national fiscal policies as proposed by the European Commission.

- The involvement of national independent fiscal institutions in fleshing out and finalizing the fiscal rules reform should be resolutely promoted with a view to supporting the parliamentary decision-making process. In the context of the surveillance process, the Fiscal Advisory Council should be involved, first and foremost, in the ex ante and ex post assessment of fiscal structure plans.