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).