FISKALRAT
Austria

Recommendations of the Fiscal Advisory Council on Austria's budget policy

Adopted at the Fiscal Advisory Council meeting on November 30, 2016

After discussing the **budget path in Austria from 2015 to 2017** at its latest meetings, the Fiscal Advisory Council presents the following **findings and recommendations:**

Funding of tax reform is below plan, but budget path for 2016/2017 exceeds expectations of the spring forecast

- According to its fall budget forecast, which is based on the September 2016 forecast of the Austrian Institute of Economic Research (WIFO), the **Fiscal Advisory Council** expects the **deficit of the general government (Maastricht definition)** to come to 1.5% of GDP in 2016 and to 1.3% of GDP in 2017. Whereas the growth of public expenditure over the forecast horizon 2016 and 2017 is relatively low, though higher than in 2015, it cannot fully offset the weak development of revenues (2016: +EUR 1.4 billion or +0.8%; 2017: +EUR 4.9 billion or +2.8%) reflecting the **tax reform of 2015/2016**. On balance, these developments result in a **notable increase in the general government deficit** compared with 2015 (2015/2016 rise: 0.5 percentage points of GDP). In 2016, Austria's tax ratio will drop to 43.1% of GDP, yet remain high by **EU-28** standards (Austria exhibits the seventh-highest revenue-to-GDP ratio according to the European Commission's fall forecast).

- From a cyclical standpoint, the Austria's **"fiscal stance"** (**change in the structural primary balance in % of GDP)**[1] showed a **slightly restrictive budget path** from 2013 to 2015. The 2015/2016 tax reform and the reduction of nonwage labor costs have reversed this trend, producing a slightly **expansive economic stimulus effect** in **2016 and 2017**. Austria is expected to exhibit a marginally negative output gap signifying underutilization of economic resources in the 2015 to 2017 period.

- The **general government deficit** forecast **for 2016** is EUR 1.8 billion or 0.5% of GDP lower than anticipated in the **spring forecast of the Fiscal Advisory Council**. External factors explain about 60% of the difference (–EUR 0.6 billion base effect,[2] –EUR 0.5 billion cyclical effect) and the update of the Fiscal Advisory Council's forecast (i.a. lower interest expenditure following settlement with the creditors of the asset management company HETA in fall 2016 and lower public investment) accounts for about 40% of the difference.

- Estimates of the Fiscal Advisory Council on the volume of revenue-side **funding measures** of the **tax reform** show that the planned additional revenue (according to ESA 2010) of about EUR 2.1 billion in 2016 is unlikely to be forthcoming. This revenue loss is, however, likely to be partly offset by additional unexpected corporate tax revenue.

- Over the forecast horizon 2016/2017, **public expenditure** will rise moderately by an average of 2.1% a year (2016: +EUR 3.1 billion or +1.7%; 2017: +EUR 4.2 billion or +2.4%). In particular **lower capital transfers** under the **support package for banks** and a drop in **interest expenditure** given the low-interest environment (2016: totaling roughly –EUR 2.3 billion) will **dampen** this increase. For the first time since 2009, the Fiscal Advisory Council's forecast assumes a very low burden on the budget from expenditures under the banking package. Not all of the funds thus freed up will result in lower expenditures; they will partly be needed for dynamic expenditure areas (i.a. health care expenditure, unemployment benefits, social security, pensions, internal and external security spending).

1 Structural primary balance excluding interest as a percentage of nominal GDP.
2 The base effect results from data revisions by Statistics Austria (in this case of ESA data until 2015) used to draw up the Fiscal Advisory Council's forecast.

Broad compliance with EU fiscal rules in 2016/2017; budgetary measures should reflect the reversal of eligible clauses from 2019 more strongly

- The **Fiscal Advisory Council welcomes** the **improved outlook for Austria's budget management** compared with spring 2016, which signals broad compliance with the **EU's fiscal rules** in **2016 and 2017** under the prevailing framework conditions. Several **expenditure packages** have recently been passed that were contained neither in the federal budget estimate for 2017 nor in Austria's draft budgetary plan for 2017 and that will burden budgets in the years to come. The Fiscal Advisory Council thus recommends ensuring compliance with **EU fiscal rules** in the coming years when implementing a set of fiscal **measures**. Proactive measures and tax incentives may act as stimuli for the economy, but they burden future budgets despite being partly self-funded.

- Compliance with EU fiscal rules in the coming years will become harder after **the reversal of the flexibility clauses currently in place** owing to outlays to manage the **refugee surge** and **counter-terrorist activities** (about 0.5% of GDP in 2016 and 2017). This fiscal flexibility will **decrease** to about 0.4% of GDP in **2018** and will **disappear completely in the years thereafter**.

- According to the **fall 2016 forecast** of the **Fiscal Advisory Council**, the **2016** structural budget deficit comes to 1.1% of GDP, a deterioration by 1.2 percentage points compared with 2015. EU fiscal rules **including flexibility clauses** allow for a deterioration of a maximum of 1.0% of GDP (change from the MTO[3] 2015: 0.5% of GDP plus 0.5% of GDP to take into account the additional costs related to refugees and counterterrorist measures). Thus, according to the Fiscal Advisory Council's fall forecast, the **structural adjustment of the deficit** deviates from the EU benchmark by a rounded amount of 0.3 percentage points in 2016. However, the **deviation** in **2016** is **lower than the "significance threshold"** of 0.5% of GDP. The Fiscal Advisory Council's forecast reduction of the structural **budget deficit for 2017** by 0.1 percentage point to 1.0% of GDP is in line with the **structural adjustment path of the EU** taking the additional costs related to refugees and the 2016 additional costs of counterterrorist measures of 0.5% of GDP into consideration. Austria should also achieve compliance with the **MTO** according to the fall forecast (adjusted for the flexibility clauses and the margin of tolerance) in 2016 and 2017.

Pushing ahead with structural reforms and infrastructure investment

- The environment of **ultra low interest rates** considerably eases the burden on the budget through lower interest payments in the years 2015 to 2017. The effect of lower interest rates in 2015 compared with 2014 is on the order of about EUR 0.5 billion for federal government debt.[4] In the coming years, interest savings are likely to diminish progressively. The low interest rate level could be exploited to make purposeful public investment or to reduce public debt.

- In Austria, it would make sense to **promote public investment** of the type that triggers further **private investment** and that is suited to meeting the challenges of demographic growth and technological advances. A look at the development of **gross public investment in Austria** in the past 20 years shows that the public investment-to-GDP ratio, which amounted to up to 3.4% of GDP after the crisis years (2008 and 2010), currently (2015 to 2017) stands at 2.9% and is thus marginally under the long-term average of 3.1% of GDP. Yet the crisis-related decline in gross fixed capital formation in Austria is largely the result of a **decrease in private rather than public investment spending**. Additionally, EU funds could be utilized more efficiently, focusing more strongly on multiplier effects.

- The **Fiscal Advisory Council** recommends that the **federal and regional governments** review whether **structural reforms** are **eligible** for the flexibility provisions of the Stability and Growth Pact (SGP). The **flexibilization** of EU fiscal rules makes it easier to invest in rule-compliant **growth stimuli** (tapping into the European Fund for Strategic Investments, EFSI; activating in-

3 A medium-term objective (MTO) of 0.5% of GDP for the structural budget deficit has been defined for Austria.
4 This calculation is based on data of the Austrian Treasury on the 2015 federal government debt and the average monthly effective interest expenses year on year from 2014 to 2015.

vestment and structural reform clauses). The current fiscal rules should be developed further to achieve a balanced approach to public consumption and investment expenditure. Unlike in the case of public consumption, the distribution over time of investment spending plays a key role in compliance with fiscal rules.

- Austria could launch a rule-consistent **structural reform plan** e.g. for **climate protection**, in the **education sector** or for **public infrastructure investment** with **initial** extra budget spending, provided a **sustainable rise in potential growth** is to be anticipated (deviations from the rules are allowed for up to three years). Spending for **planned public investment** (e.g. the Austrian railway ÖBB investment framework or the expansion of the broadband infrastructure) was **below target** in 2015 and 2016.

- The Fiscal Advisory Council encourages carrying on with the measures to **combat benefit and tax fraud** at the national and international level and pushing ahead with the **harmonization of tax rules** at the international level.

- The **Fiscal Advisory Council encourages strengthening investment in the integration of asylum seekers and persons entitled to asylum in Austria** to tap the economic potential of the **new immigrant refugees** and to minimize the medium- and long-term public finance burden. The short-term and long-term effects of possible related investment measures must be duly considered, as must different regional conditions. Rapid **integration into the labor market** reduces the burden on the budget already **in the short term**, whereas **investment in education** and new ways of **facilitating access to the job market** have **medium- to long-term effects**, which, however, are **stronger** over time. The federal government's most recent efforts to simplify the recognition of qualifications and to shorten the duration of asylum proceedings are to be welcomed. In the long run, raising the employment rate of refugees to the Austrian level appears particularly important, above all in view of the low participation rates of women refugees.

Agreement on Fiscal Sharing Act for 2017 to 2021 should be seen as a first step toward the reform of federalism in Austria

- The **Fiscal Advisory Council welcomes** the restructuring of the fiscal sharing rules for 2017 to 2021 and the **preparation of federal government reform until the end of 2018** based on the work of the Austrian Convention, an endeavor that should be moved ahead at the **highest political level**. In a first step, implementing this important and difficult project is likely to require **political agreement** on the **strategic objectives of the overall federal government reform** against the background of tasks undertaken jointly by different levels of government (i.a. health care, social affairs, education, subsidies, public service and pension regulations, the setting of cost-driving standards, tax law).

- Critical **task and spending reviews** as agreed in the form of a **benchmarking model** in the **new fiscal sharing rules** would be a good starting point for the design of federal reforms. The results of these reviews in combination with the strategic objectives could result in a **reform of structures and tasks** undertaken jointly by different levels of government that should be guided by the goal of **broad transparency** and **unified responsibility for public functions, spending and funding**. This reform could not only reinforce incentive mechanisms for sustainable budget management, it could also achieve simpler structures disentangling transfers. A transparent and comprehensive representation of financial flows between federal, regional and local authorities is needed. At present, the provinces have spending power, but their revenues are determined largely by fiscal sharing and intergovernmental transfers.

- Under the new fiscal sharing arrangements, the **promotion of residential building**, which has a direct impact on the **amount of nonwage labor costs**, was redesignated as a purely **regional tax** to strengthen the provinces' autonomous tax management. The **Fiscal Advisory Council** encourages use of the contributions to housing subsidies for housing purposes.

- The **structural increase in revenues of regional and local authorities** agreed in the new fiscal sharing arrangement at the expense of the federal government, amounting to EUR 300 million a year, must be questioned against the background of the subsectoral **objectives of the 2012 Austrian Stability Pact (ÖStP 2012)** and must be seen as representing a shift to greater task orientation. In this respect, the regional and local authorities exceeded their objectives under the 2012 Austrian Stability Pact in 2015, whereas the federal government fell short of the targets as a result of exceptional expenses (e.g. for the banking package, for the surge in refugees). Also, given the **EU fiscal rules**, the **national impact** of any change in the **distribution of budget funds among public authorities** should always be taken into account and disclosed.

- With the adoption of the **2012 Austrian Stability Pact**, Austria fulfilled its obligations under the European fiscal compact. **This framework will be fully implemented by 2017,** providing for a system of regional fiscal rules for Austria's federal, regional and local governments, which essentially corresponds to the EU's fiscal framework and which will further increase complexity. The **operational implementation** and **control** of these regional fiscal rules – especially the structural budget and expenditure rules – is particularly difficult and resource-consuming at the local government level, and the Fiscal Advisory Council believes it could be simplified, provided compliance with the general government targets remains ensured.

Long-term risk management methods and greater transparency to improve budget management

- The **Fiscal Advisory Council** welcomes the approach taken by the federal, regional and local authorities to continue to seek **low-risk and diversified** funding and to introduce **transparent limits for guarantees** provided at all government levels from the beginning of 2019. Additional information about existing public guarantees (e.g. guarantor, probability of default or breach of the upper limit) would enhance transparency.

- The strategy of the federal government to incur above all **long-term and fixed interest** debt (taking into account the time structure of repayments) currently appears to make good sense, given the historically low interest rate level and the flat yield curve, not just for the **federal government but also for all other government authorities**. Closer **cooperation** on debt management including the related risk management between the federal government, the federal government authorities and the regional authorities is expedient and should be intensified.

- Currently, several factors make it **difficult** to provide an **overall assessment** of the **transfers of funds between regional and local governments** and an the collection of **adequate statistical information** on regional government expenditure in Austria (under the ESA 2010 definition): a lack of specifications and differentiation in accounting standards, heterogeneous recording/accounting practices across the different Austrian provinces and the involvement of different players (government entities) in individual tasks (regional funds, municipal cooperatives, extrabudgetary companies). The **Fiscal Advisory Council urges quick action to remedy** this situation. Moreover, greater transparency is needed in the area of public **subsidies**, with **subsidy reports** to be drawn up by all federal, regional and local authorities.

- In the current **historically low interest rate environment**, the bulk of the federal debt carries negative yields, with the temporary public sector purchase programme of the European Central Bank contributing substantially to this situation. The **Fiscal Advisory Council** recommends taking **debt management measures to counteract the dangers of rising interest rates** and to include the relevant risk scenarios in plans. Care must be taken to keep the investor base broad.

- After conclusion of settlement with the creditors of HETA, the Fiscal Advisory Council recommends **clarification** of **liability relationships** between the federal government and the regional authorities and **enshrinement** of this relationship in constitutional law. **Procedural rules** for dealing with **imminent insolvency** of individual public authorities would be expedient.