

SUMMARY OF THE FISCAL RULES COMPLIANCE REPORT FOR 2015 TO 2020 (MAY 2016)

In the following we will present an evaluation of Austria's expected compliance with EU fiscal rules over the coming years. To this end, we will compare the budget path outlined in the Austrian government's current stability program with the **Fiscal Advisory Council's own fiscal forecast** for the years **2016 and 2017** and its own calculations of the output gap (**Fiscal Advisory Council's spring forecast**). The calculation of the output gap for the purpose of cyclically adjusting the fiscal balance as presented in the Fiscal Advisory Council's spring forecast is in line with the methodology of the European Commission; the results correspond to those presented by the Austrian Institute of Economic Research WIFO (March 2016). The Fiscal Advisory Council's spring forecast takes into account the **tax reform of 2015/16**, including the **compensatory measures** needed to fund this reform, as outlined in the draft laws on the tax reform of May 2015, with the exception of the discretionary compensatory measures on the expenditure side in the areas administration, grants and subsidies.

The **2012 Austrian Stability Pact** (ÖStP 2012, Federal Law Gazette I 30/2013) – an agreement between Austria's federal government, provinces and municipalities pursuant to Article 15a Federal Constitutional Law – not only lays down binding subsectoral fiscal rules but also regional fiscal rules (for each province and for the municipalities in each province).¹ The present analysis does not evaluate compliance with these national fiscal rules.

Austria's compliance with EU fiscal rules according to the Fiscal Advisory Council's 2016 spring forecast

Maastricht deficit will widen in 2016 and 2017 compared to 2015 but will remain well below the limit of 3% of GDP

The **Fiscal Advisory Council's spring forecast** expects Austria's general government deficit ratio to rise to 2.0% of GDP in **2016**, after 1.2% of GDP in 2015. This **deficit increase** can be mainly attributed to the following factors:

- net effect of the **tax reform** of 2015/16 (+EUR 1.8 billion);
- additional expenditure on **assistance for refugees** (+EUR 1.2 billion);
- **2015 anticipatory effects** due to the land transfer tax and the announced increase in the capital gains tax rate (some EUR 1 billion) no longer apply;
- **Proactive measures**, e.g. increased funding for universities, research and broadband internet infrastructure (EUR 0.7 billion).

According to the Fiscal Advisory Council's spring forecast, the deficit ratio is expected to decline slightly in **2017** to 1.9% of GDP. In 2017, deficit-increasing measures (e.g. net effect of the tax reform and reduction of non-wage labor costs) will be accompanied by reduced expenditure, achieved inter alia by a rollover of government debt against the background of the currently low market interest rates, and by less spending on proactive measures. The **budget deficit** will thus remain **markedly below the ceiling** of 3% of GDP, which means that **Austria will be in clear compliance with the (nominal) deficit rule throughout the entire forecast period** (see table). This is in line with the government's current stability program (2015 to 2020), which outlines a **budget path** that complies with the Maastricht

1 On the further evolution of Austria's subnational fiscal rules see Grossmann and Hauth (forthcoming, July 2016).

Table: Compliance with EU fiscal rules according to the Fiscal Advisory Council's 2016 spring forecast and the government's 2016 stability program

General government budget, total	European Commission	Fiscal Advisory Council estimate			Federal Ministry of Finance estimate		
	2015	2015	2016	2017	2015	2016	2017
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓
Medium-term objective (incl. margin of tolerance)¹	✓	✓	⊗	⊗	✓	⊗	⊗
Structural adjustment of deficit ratio^{2) 3)}	✓	✓	⊗	⊗	✓	⊗	⊗
Government expenditure growth⁴⁾	⊗	⊗	✓	⊗	⊗	✓	⊗
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)							
Fiscal balance (Maastricht definition)	-1.2	-1.2	-2.0	-1.9	-1.2	-1.6	-1.5
Structural budget balance	0.0	0.0	-1.5	-1.6	0.0	-0.9	-1.0
Total expenditure (real, adjusted, change in %)	.	-0.6	1.6	1.4	-0.6	1.5	1.4
Debt (year-end figures)	86.2	86.2	84.3	82.8	86.2	84.3	82.6

Note: ✓ ... fiscal rule has been met, ⊗ ... fiscal rule has not been met, ⊗ ... fiscal rule has not been met and significant deviation⁵⁾

1) If Austria reaches the medium-term objective (MTO), noncompliance with structural adjustments of the deficit ratio or the expenditure rule will not trigger procedural steps.

2) Reduction of the structural deficit subject to macroeconomic conditions, the level of the debt ratio and the remaining need for adjustment to reach the MTO.

3) According to the Federal Ministry of Finance estimate, the deviation of the deficit ratio will only be slightly above the significance threshold in 2017.

4) Average medium-term potential growth rate less a certain percentage (convergence margin) as long as the MTO has not been reached.

5) A deviation is deemed significant if the structural deficit deviates by at least 0.5% of GDP from the structural adjustment path or the MTO within one year or cumulated over two years. A deviation from the debt rule during the transition period is deemed significant if the structural adjustment deviates from the required minimum linear structural adjustment (MLSA) by more than 0.25% of GDP.

Source: Federal Ministry of Finance (stability program of April 2016), WIFO (March 2016 outlook), European Commission (May 2016 outlook) and Fiscal Advisory Council's own calculations.

deficit rule. The **stability program** predicts a lower increase in the Maastricht deficit (to 1.6% of GDP) than the Fiscal Advisory Council's spring forecast for 2016.

Like the Fiscal Advisory Council, the Austrian government expects a small decrease in the Maastricht deficit in 2017, to 1.5% of GDP, against the background of improved economic conditions and lower interest payments.

Risk of a significant deviation from the EU's structural budget rule in the forecasting period

The Fiscal Advisory Council's calculations on potential output according to the the European Commission methodology (based on the current macroeconomic forecast by WIFO) point to “normal” economic times according to the European Commission definition, i.e. output gaps between +/- 1.5% of potential output. The calculations for 2015 yield a marginal structural surplus of 0.0% of GDP as a basis of reference for the structural adjustment path for 2016 and 2017. This means that, for 2016, a deterioration of

the structural fiscal position by 0.5 percentage points would be admissible without jeopardizing the medium-term objective (MTO). However, the Fiscal Advisory Council's spring forecast projects a **structural deficit in the amount of 1.5% of GDP for 2016**, which would result in a “**significant**” **deviation from the adjustment path and the MTO** according to the EU definition.

In **2017**, the structural deficit as specified in the Stability and Growth Pact (SGP) would need to contract by 0.6 percentage points to ensure compliance with the structural budget rule. However, in its spring forecast, the Fiscal Advisory Council predicts a small increase in the structural budget deficit to 1.6% of GDP in **2017**, which means a **significant deviation from the adjustment path and the MTO** is to be expected. This increase reflects cyclical aspects: The cyclical component of the budget balance will shrink on the back of economic recovery, but this will not be fully reflected by the Maastricht deficit.

This means that the **Fiscal Advisory Council's spring forecast** – contrary to the federal government's current stability program – points to the **risk of a significant deviation from the structural adjustment path** under the preventive arm of the SGP **that will persist over the entire forecast horizon** (according to the 1- and 2-year assessment). Based on an **in-depth ex-post analysis** by the European Commission, the Council of the European Union will decide on procedural steps **in spring 2017 (significant deviation procedure)**.

This overall assessment by the European Commission will consider the **additional expenses in 2016 as compared to 2015 for assistance to refugees as “exceptional circumstances”** as defined in the SGP (according to the Fiscal Advisory Council's estimate: 0.3% of GDP). Still, the risk of a **significant** deviation remains (1-year assessment): Austria will fail to comply with the structural budget rule by 0.7% of GDP in 2016; to avoid a qualification as “significant,” this deviation would need to be 0.2 percentage points lower. For the year 2017, the Fiscal Advisory Council's spring forecast does not anticipate any additional expenditure related to assistance for refugees that might have a bearing on Austria's compliance with EU fiscal rules.² In 2017, the deviation will be 0.3% of GDP above the significance threshold. However, the outlook is subject to some uncertainty. Regarding the **consideration of additional expenditure** for assistance to refugees when assessing costs with a bearing on EU fiscal rule compliance, the European Commission's general distinction between temporary and longer-term expenditure appears **fuzzy**. Also, one could raise the question if it might not be more advisable to use 2014 as the base year for determining additional expenditure related to refugee assistance (the year prior to the sharp increase in the number of arriving refugees).

According to the general government budget path outlined in April 2016, the **federal government expects a smaller deviation from the MTO**, i.e. by 0.4% of GDP in 2016 and 0.5% of GDP in 2017. While the MTO is still expected to be met in 2016 based on the exclusion of additional expenditure related to assistance for refugees (including the margin of tolerance of 0.25 percentage points), the possibility of a marginal breach of the **significance threshold** is seen for 2017. Compared to the Fiscal Advisory Council's spring forecast, the Austrian Federal Ministry of Finance assumes lower Maastricht deficit values and higher one-off measures (bank aid measures), resulting in **lower structural deficit values**.

Spending rule complied with in 2016, significant breach of spending limits in 2017

Based on its current spring forecast, the Fiscal Advisory Council expects an average **nominal increase in public spending** of 2.5% per year between 2015 and 2017. The average annual rise in **real govern-**

² This means that the assessment of fiscal rule compliance in 2017 would remain unaffected should the European Commission decide to extend the exceptional provisions to 2017.

ment expenditure (adjusted)³, on which the assessment of spending rule compliance is based, amounts to 1.0% for 2015 to 2017.

The assessment of compliance with the spending rule for the years **2015 to 2017** is based on a comparison of the increase in **(adjusted) real aggregate expenditure** and the average medium-term **potential growth rate** (according to the European Commission). As long as the MTO is not complied with, a Member State's increase in expenditure must be steered in a manner that ensures an adjustment of the structural budget balance toward the MTO in line with the respective structural targets. Taking into account applicable add-ons to or deductions from the reference rate, the following **upper limits** apply to increases in real aggregate spending in Austria:

- +1.2% in 2015 (taking into account an add-on of 0.1 percentage points),
- +2.0% in 2016 (taking into account an add-on of 1.0 percentage points),
- -0.1% in 2017 (taking into account a deduction of 1.2 percentage points).

According to the Fiscal Advisory Council's current spring forecast, the **annual rate of increase in adjusted real aggregate spending** varies strongly in the period under review, as **expenditure is not adjusted for one-off measures** when assessing **spending rule compliance** and as the admissible spending increase depends on **compliance/noncompliance with the MTO** in the year t-1:

- In **2015**, the fact that extraordinary expenditure in connection with the establishment of HETA (the winddown vehicle for Hypo Alpe Adria AG) no longer had to be reflected in the budget balance led to a decline in real expenditure growth by 0.6%; hence **spending growth** remained **well below the reference value (1-year assessment)**. However, a look at average real expenditure growth in 2014 and 2015 (**2-year assessment**) reveals a **significant deviation from the target values**, but this deviation has no bearing as the MTO is complied with.
- For **2016**, the marked **real expenditure increase** of 1.6% as projected by the Fiscal Advisory Council in its spring forecast is **in line with the spending rule**, as the better-than-required performance with regard to the 2015 MTO implies a rise in (an add-on to) admissible spending growth for 2016.
- For **2017**, by contrast, the rise in real government expenditure by 1.4% represents a **significant overshooting** of the reference rate according to the EU definition as, following the clear failure to meet the MTO in 2016, it would be necessary to even marginally reduce real spending in 2017.

In view of the significant breach of the spending rule in 2017, there is the risk that **the early warning mechanism (significant deviation procedure)** could be triggered in **spring 2018**, also because non-compliance with the structural budget rule will be significant in 2017, too. Despite these clear indications based on calculations, any procedural steps will depend on an in-depth **overall assessment** by the European Commission, which will provide the basis for the decision by the Council of the European Union.

The **federal government's current stability program**, by comparison, projects a real spending growth rate for 2017 that will deviate from the spending rule but without quite reaching the significance threshold. Also, based on the stability program, there is the risk of a significant deviation in the context of the structural budget requirements; this confirms the **Fiscal Advisory Council's overall assessment** that EU rule compliance will be a particular challenge in 2017.

³ Aggregate spending does not include interest payments or cyclical spending on unemployment benefits; discretionary income is considered.

Debt rule complied with in 2016 and 2017

To ensure that at least the future-oriented debt benchmark, i.e. the **debt rule**, is complied with **at the end of the transition period** (2016), Austria needs to achieve a **minimum adjustment of its structural budget balance of –1.6%** of GDP in 2016. Therefore, the structural budget balance would be allowed to markedly deteriorate in 2016 – because of the better-than-expected performance with regard to the structural budget requirements in 2014 and 2015 – without causing a breach of the debt rule in the transition period. From 2017, the debt rule under the SGP will be applied in full.

In its **spring forecast**, the **Fiscal Advisory Council** anticipates a clear increase in the structural deficit ratio in **2016** by 1.5 percentage points. Nevertheless, the required structural minimum adjustment will be achieved in 2016; this means **the debt rule will be complied with in the transition period**. In **2017**, Austria will remain below the cyclically adjusted benchmark and thus below at least one of the three benchmarks. Accordingly, the **general government debt path as assessed by the Fiscal Advisory Council** – and as assessed by the federal government in its current stability program – **fully complies** with the **requirements of the debt rule**.

Fiscal Advisory Council's overall assessment of Austria's fiscal position in 2016 and 2017

According to the Fiscal Advisory Council's spring forecast, Austria will fulfill the Maastricht criteria in 2016: Austria's **general government deficit** will remain **clearly below the limit** of 3% of GDP (Maastricht) in 2015 to 2017. However, in **2016 and 2017**, the reduction of the Maastricht deficit observed in recent years will be interrupted, primarily because of the net effect of the **tax reform of 2015/16, proactive measures** and the **additional expenditure related to refugee assistance**. **The general government debt ratio will be reduced in line with the debt rule**. Against this background, there is **currently no risk** of an **excessive deficit procedure** or a report under Article 126(3) TFEU in the forecasting period. Consequently, it can be assumed that Austria will remain subject to the provisions of the preventive arm of the SGP. In terms of **structural budget requirements, however, there is the risk** of a **significant deviation** (as defined by the EU) from the structural adjustment path and the medium-term budget objective in **2016 and 2017**. The Fiscal Advisory Council also anticipates a significant breach of the **spending rule** in 2017.

According to the **Fiscal Advisory Council's current forecast**, the **Maastricht budget deficit** – after coming to 1.2% of GDP in 2015 – will undergo a marked rise in 2016 to 2.0% and then decline slightly to 1.9% of GDP in 2017. This expectation is primarily based on the budgetary effects of the **tax reform of 2015/16**, the additional expenditure in connection with **assistance to refugees** and the increase of funding for **proactive measures**, on the one hand, and dampening effects arising from previous consolidation packages, low public funding in aid of nationalized banks and declining interest payments due to the rollover of government debt, on the other hand. Though the government's expansive measures are stimulating domestic demand and thus economic growth, they are increasing Austria's public debt at the same time.

The 2015/16 **tax reform** was aimed in particular at cutting income taxation rates, with a view to reducing taxes on labor and stimulating demand as a driver of growth. The tax reform plan also contained compensatory **revenue measures** (inter alia: tax fraud prevention, increase in capital gains taxes, elimination of tax exemptions, etc.). The fiscal effects of these measures, especially those targeted at fraud prevention and a change in taxpayer behavior, are difficult to gauge at the moment. In addition, **non-wage labor costs** are to be lowered in several stages; these reduction measures will have been implemented in full by 2018 and amount to a volume of EUR 1 billion. Overall, there are some tentative signs of a **change in Austria's tax structure** designed to improve the country's growth perspectives; a

sustainable reduction of the tax-to-GDP ratio by about one percentage point can be expected. **On the expenditure side**, measures have been scheduled in the areas **public administration, grants and subsidies**; these have not been specified yet, however. This is why, in line with the Fiscal Advisory Council's forecasting guidelines, possible discretionary spending cuts in these areas have not been taken into account.

The large number of **refugees** arriving in Austria has prompted the federal government to increase budget resources for **basic welfare support**, but also for **internal security** and **border management** (including border protection). Additional funds of EUR 0.5 billion in total have been earmarked for **integration measures** in 2016 and 2017. Overall, the Fiscal Advisory Council expects additional, refugee-related general government expenditure of EUR 1.2 billion for 2016 (including costs of providing means-tested minimum benefits).

The Austrian government continues to provide under its proactive measures package funding in important future-oriented areas, such as education, research and infrastructure (e.g. for childcare facilities and day care arrangements at school), and is increasing funding in some areas; from 2016, the federal government plans a considerable increase in funding for **universities and other academic institutions (Fachhochschulen)** and for the purpose of expanding Austria's **broadband internet infrastructure**. In this context, the Fiscal Advisory Council recommends that the federal government review whether planned structural reforms and investment projects are eligible for the flexibilization clauses under the SGP.

The reduction of the Maastricht deficit as planned by the federal government from 2017 (stability program 2015 to 2020) is primarily based on the improvement of overall economic conditions, the assumed decline in capital transfers (one-off measures for the nationalized banks) as well as a decrease in spending on border management and protection owing to a strengthening of European solutions. The federal government has hardly presented any **specific plans for structural reforms designed to ensure the sustainable achievement of the medium-term budget objective**.

As regards the **structural budget deficit**, the federal government's current stability program outlines a **temporary increase** in 2016 and 2017 (0.9% and 1.0% of GDP, respectively), while adhering to the medium-term budget objective from 2018.

The European Commission expects in its spring forecast the structural budget deficit to increase in 2016 to a level that corresponds to that provided in the **federal government's current stability program** (0.9% of GDP) and to exceed the ratio projected by the Austrian Federal Ministry of Finance (1.0% of GDP) in 2017 (at 1.2% of GDP). Factoring in the exceptional financial burden related to providing assistance for refugees (0.3% of GDP each in 2016 and 2017) and a possible margin of variation, the European Commission expects Austria to meet the MTO by a narrow margin in 2016. For 2017, the European Commission's forecast sees Austria missing the MTO, with the deviation – at 0.3% of GDP – not being “significant,” however. Clearly, the European Commission's forecast is more optimistic than the Fiscal Advisory Council's outlook. The compensatory measures needed to fund the 2015/16 tax relief package remain one of the main fiscal risks, according to the European Commission. It also calls upon the government to strengthen the sustainability of the health care and the pension systems and to adopt measures to streamline responsibilities and funding structures at the regional level.

Based on the **results of the Fiscal Advisory Council's current forecast**, it seems possible that compliance with the **budget requirements** under the preventive arm of the SGP, which is evaluated based on the **development and size of the structural budget balance and real expenditure growth**, might be **jeopardized in 2016 and 2017**:

- Austria can be expected to **significantly miss** (EU definition) its **medium-term budget objective in 2016 and 2017** (MTO: –0.45% of GDP until 2016, –0.5% of GDP from 2017), after a better-

than-required performance in the two preceding years.

- In **2017**, annual **real expenditure growth** will surpass the admissible reference rate by a considerable margin and will display a **significant deviation** from the required structural adjustment path, while in **2016** spending growth will remain well below the maximum admissible rate.

From today's perspective, there is the risk, looking at both 2016 and 2017, that the **early warning mechanism of the preventive arm of the SGP** could be triggered in **spring 2017 or 2018 (significant deviation procedure)** if overall economic conditions do not improve markedly. Ultimately, it is the **Council of the European Union** that evaluates the fiscal position of a Member State and decides on procedural steps (in the spring following the relevant fiscal year), based on an **in-depth overall assessment** by the European Commission which also includes (real) public expenditure growth. The Fiscal Advisory Council is critical of the European Commission's calculation method for excluding expenditure earmarked for assisting refugees (as regards dating and defining such expenditure and assessing additional expenditure compared to the previous year instead of the base year 2014).

Finally, it should be emphasized that **efforts to integrate refugees in Austria into society as quickly as possible** could eventually reduce the total costs of integration to the public purse. Such efforts (including, e.g., providing trainings, facilitating access to the labor market, providing increased incentives for integration, implementing uniform standards across all provinces regarding means-tested minimum benefits and integration measures) should be implemented fast.

Furthermore, enhancing **efficiency**, especially in areas in which **central, regional and local authorities** carry responsibilities, such as **education, health care, care, local public transport**, are top priorities; equally, **reorganizing the fiscal sharing framework** (as envisaged by the federal government) is of utmost importance.