KEY RESULTS OF THE AUSTRIAN FISCAL ADVISORY COUNCIL'S REPORT ON PUBLIC FINANCES 2016-2018[1]

Fiscal position from 2016 to 2018 and fiscal stance of the general government[2]

2016 general government deficit on the rise as expected; several slight breaches of EU fiscal rules in 2016

Austria's general government deficit expanded substantially in 2016 compared with 2015, as the Fiscal Advisory Council had predicted in previous forecasts. According to preliminary results provided by Statistics Austria, the government deficit amounted to 1.6% of GDP, following 1.0% of GDP in the previous year (table 2). The expansion was caused by **revenue shortfalls** triggered by the **2015–16 tax reform**, which went hand in hand with **faster government expenditure growth**.

The **tax reform** brought **cuts in wage and income tax rate**s and therefore had a marked dampening impact on general government revenue growth in 2016. The **revenue measures** taken to fund the tax cuts fulfilled expectations only to some extent; the changes in connection with the **VAT tax** (partial increase in reduced VAT rates, measures to combat tax fraud) yielded considerably less additional revenues than forecast, but this shortfall was partly offset by an unexpected rise in **corporate income tax** revenues. In sum, the **revenue-generating effects** of the tax reform[3] and the **revenue measures adopted to fund the reform** (VAT hikes, increase in the capital gains tax on real estate sales and in the tax on capital gains and dividends, anti-fraud measures) did not suffice **in 2016** to fully compensate for the loss in revenues generated by the tax reform. In fact, 2016 saw an unusually slow increase in **government revenues** (by merely 0.7% or EUR 1.3 billion) compared with the previous year (2015: +4.1% or +EUR 6.7 billion).

Austria's tax ratio (national definition) dropped to 42.3% of GDP in 2016, down from 43.2% in 2015 (table 4). By **international standards**, Austria's tax-to-GDP ratio remains high.

From a cyclical point of view, Austria's **fiscal stance**[4] is **countercyclical** for 2016, which has an expansionary effect in times of **economic slack** (chart 1).

The **structural budget balance** (also taking into account the application of **eligible clauses**)[5] deteriorated from a surplus of 0.1% of GDP in 2015 to a deficit of just above 0.5% of GDP in 2016, according to **Fiscal Advisory Council figures**.[6] Although the application of eligible clauses that allow temporary allowances for refugee- and counter-terrorism-related expenditure led to a decrease in Austria's structural budget balance by 0.4% of GDP, Austria still breached the **MTO deficit threshold** of 0.45% of GDP.

1 Budget data up to 2016 reflect the data available in September 2017. Budgetary outcomes for 2017 and 2018 are forecasts (generally the 2017 fall forecast of the Fiscal Advisory Council).

2 For statistical information (time series), see annex.

3 Positive demand effects (e.g. increase in private consumption) that generate additional tax revenues.

4 Change in the structural primary balance ratio (as a percentage of GDP) in relation to the output gap.

5 The calculation of the structural budget balance including eligible clauses does not take into account one-off effects (spending on the banking package) as well as expenditure related to extraordinary events (i.e. assistance to refugees, counter-terrorism measures) as well as additional revenues and less expenditure because of the economic upswing in 2016 (cyclical component of the budget).

6 While this deterioration was within the normal margin of tolerance of 0.25 percentage points, this margin of tolerance does not apply when the eligible clauses are invoked.

Table 1: Assessment and preliminary results of Austria's budget path for 2016

% of GDP	Net lending/borrowing 2016[1] MoF	FISK	EC	Structural budget balance 2016[2] MoF	FISK	EC
2015	-1.4	-2.2	-1.6	-0.5	-1.4	-1.0
April/May 2016	-1.6	-2.0	-1.5	-0.9	-1.5	-0.9
2016	-1.4	-1.5	-1.5	-0.9	-1.1	-1.0
April/May 2017	-1.6	-1.6	-1.6	-1.0	-1.0	-1.0
2017	-1.6	-1.6	-1.6	-0.9	-0.9	-1.0

1) General government budget balance according to the ESA 2010.
2) Including additional cost of assistance to refugees and of counterterrorism measures.
Source: Ministry of Finance (Stability Programme and Draft Budgetary Plan), FISK (fiscal forecast), EC (economic forecast), Statistics Austria.

Table 2: Budget balances of the subsectors of the general government, 2014 to 2018

	Central government		State governments (excl. Vienna[1])		Local governments (incl. Vienna[1])		Social security funds		Total	
	bn EUR	% of GDP	bn EUR	% of GDP	bn EUR	% of GDP	bn EUR	% of GDP	bn EUR	% of GDP
2014	-9.2	-2.8	0.1	0.0	-0.1	0.0	0.3	0.1	-9.0	-2.7
2015	-3.9	-1.1	0.2	0.1	0.0	0.0	0.1	0.0	-3.6	-1.0
2016	-4.5	-1.3	-1.3	-0.4	-0.2	-0.1	0.2	0.1	-5.8	-1.6
2017	.	.	.	.	.	.	.	.	-2.6	-0.7
2018	.	.	.	.	.	.	.	.	-2.5	-0.6

1) In the Austrian Stability Pact, Vienna (as state and local government) is included in the state government level.

Source: Statistics Austria, Austrian Institute of Economic Research (GDP) and Fiscal Advisory Council's fall forecast (2017 and 2018).

Table 3: Budget balances and structural balances of the general government, 2014 to 2018

% of GDP	Net lending/borrowing FISK	EC	Structural budget balance FISK	EC	Structural budget balance incl. clauses[1)] FISK	EC
2014	-2.7	-2.7	-0.7	-0.8	.	-0.8
2015	-1.0	-1.0	0.1	-0.3	0.2	-0.2
2016	-1.6	-1.6	-0.9	-1.0	-0.5	-0.6
2017	-0.7	-1.0	-0.6	-0.9	-0.2	-0.5
2018	-0.6	-0.9	-1.0	-1.0	-0.7	-0.7

1) Including additional cost of assistance to refugees and of counterterrorism measures.
Source: Statistics Austria, Austrian Institute of Economic Research (GDP), European Commission's and Fiscal Advisory Council's fall forecast 2017.

The European Commission's current autumn forecast confirms the assessment described above, expecting a structural deficit 0.1 percentage point above the ratio forecast by the Fiscal Advisory Council.

With regard to the **structural budget balance** and **fiscal stance** parameters it must be noted that the figures provided are analytical results that critically depend on the potential output, which, in turn, is typically subject to revision (even if past data are used).

Table 4: Government ratios: general government total expenditure, revenue and taxes, 2014 to 2018 (% of GDP)

% of GDP	2014	2015	2016	2017	2018
Expenditure[1]	52.3	51.0	50.7	49.4	48.8
Gross capital formation	3.0	3.0	3.0	3.0	3.0
Interest payments	2.4	2.3	2.1	1.8	1.6
Revenue[1]	49.6	49.9	49.1	48.6	48.1
Tax revenue (national definition)[2]	42.8	43.2	42.3	42.0	41.7
Tax revenue (international definition)[3]	43.5	43.8	42.9	42.6	42.3

1) Interest payments excluding swap transactions.
2) General government tax revenue including actual social contributions (compulsory contributions only; ESA codes: D2+D5+D611+D91-D995); including EU own resources.
3) National tax revenue and imputed social contributions.
Source: Statistics Austria, Austrian Institute of Economic Research (GDP) and Fiscal Advisory Council's fall forecast (2017 and 2018).

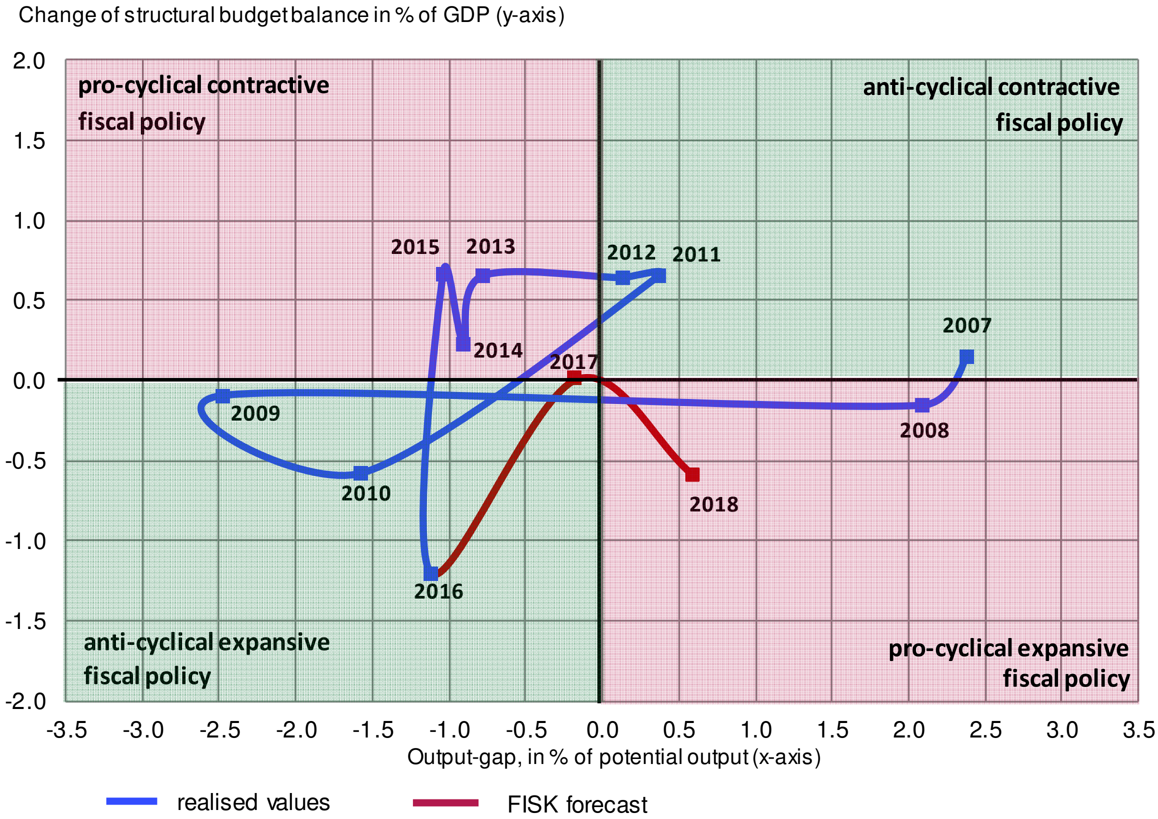
Furthermore, Austria **failed to** comply with the **expenditure rule** in 2016 (table 5). **Government expenditure** rose by EUR 3.5 billion (i.e. 2.0%) despite significantly less spending on the banking package (–EUR 2.1 billion compared with 2015) and **declining interest payments** on government debt given the low interest rate environment (2016: –EUR 0.6 billion). This increase was mainly attributable to several economic policy measures and changes in overall conditions as a result of which expenditure grew at 4%, a rate beyond that of nominal economic growth in three key areas: **social security** (related, inter alia, with assistance for asylum seekers, a one-off payment of EUR 100 to pensioners and increased participation in subsidized part-time working schemes for older employees), **health care** (i. a. increased benefits in long-term care and the effects of changes in employment regulations for doctors) as well as **investment in infrastructure and security** (including investment in the Austrian Federal Railways, broadband connectivity, the Austrian armed forces and the police). The **government expenditure ratio** came to 50.7% of GDP in 2016 (2015: 51.0% of GDP).

Austria's **budget positions** deteriorated **at all levels of government** in 2016. At the federal level, a Maastricht deficit of 1.3% of GDP was recorded (2015 deficit: 1.1% of GDP), while the regional governments posted a deficit of 0.4% of GDP (2015 surplus: 0.1% of GDP) and the local government deficit stood at 0.1% of GDP (2015 deficit: 0.0% of GDP). The deterioration at the **regional level** is primarily attributable to a **one-off effect** related to the **Carinthian settlement payment fund** (Kärntner Ausgleichszahlungs-Fonds, KAF), repercussions from the 2015–16 **tax reform** (**less federal tax revenues** to be shared with regional and local governments) and a substantial rise in expenditure on social transfers to households in connection with the immigration of refugees. The winding down of HETA had a **one-off effect** on **Carinthia's** Maastricht deficit, increasing it to some EUR 1.2 billion or 0.3% of GDP and accounting for about 70% of the deterioration of the government budget position at the regional level.[7]

7 This payment is considered to be an intra-government transfer and therefore has no impact on the general government budget deficit.

Figure 1

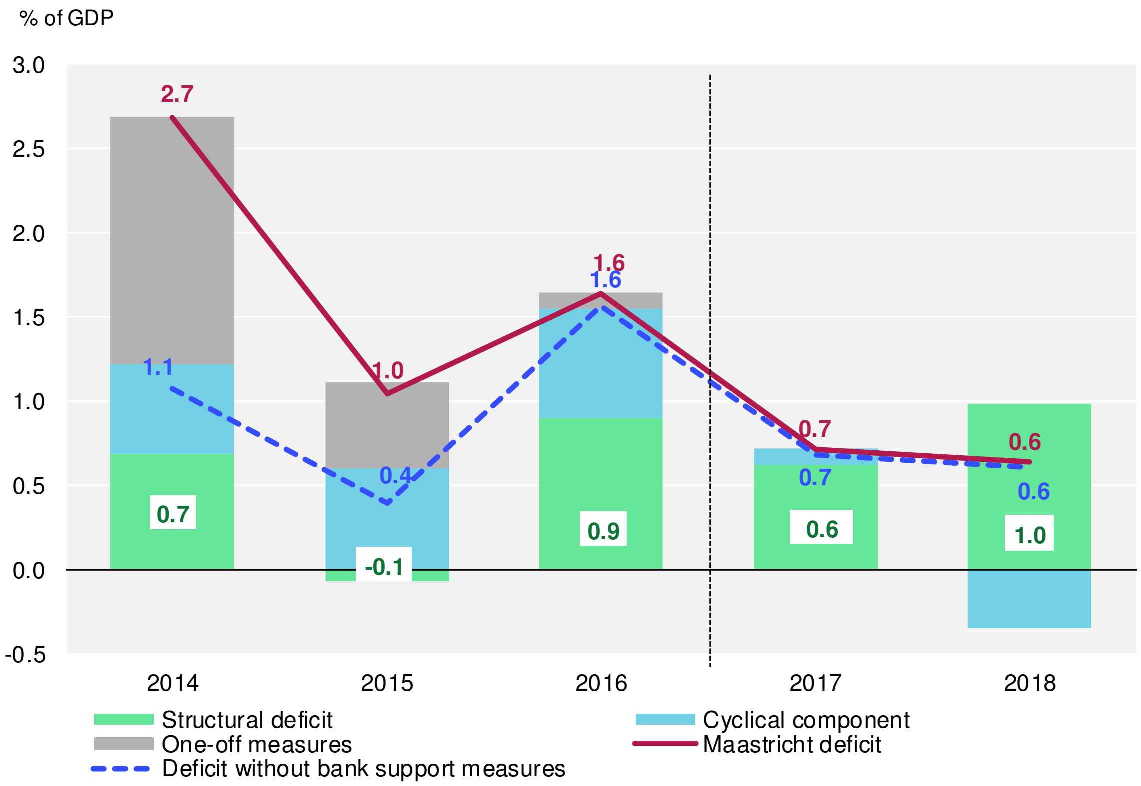
Structural primary balance of gen. govnt. and output gap 2007 to 2018



Source: Statistics Austria, WIFO and FISK autumn forecast (for 2017 and 2018).

Figure 2

General government deficit and its components 2014 - 2018



Source: Statistics Austria, WIFO and FISK autumn forecast (for 2017 and 2018).

Austria's fiscal position improves in 2017 on the back of economic upswing; fiscal rules expected to be largely complied with

Government revenues are set to **increase at a considerably faster pace** – by 3.8% or EUR 6.7 billion – in **2017**, according to the Fiscal Advisory Council's fall forecast. General government revenue growth has been driven by the significantly better performance of all relevant **macroeconomic indicators** and the fact that the **shortfall in tax revenues** caused by the cuts in wage and income tax rates is **no longer relevant**.[8] In addition, the contribution of the non-indexation of the tax system to revenue growth is gradually increasing over the forecast horizon 2017–18 owing to higher wages and inflation rates (the non-indexation of the tax system causes wage and income taxes to rise disproportionately more quickly due to bracket creep on the one hand and to be dampened by the disproportionately slower growth of revenues from quantity taxes). At the same time, revenue growth is expected to be dampened by the gradual reduction of **nonwage labor costs** (by the reduction of employers' contributions to the Family Burden Equalization Fund) in 2017 and 2018 and the slow growth of **revenues in categories** that tend to be **acyclic** (including other current transfers and investment income).

Nominal government expenditure growth is forecast to reach about the same rate in 2017 (+1.9%) as in 2016 (+2.0%) against the background of **numerous fiscal spending measures** (in particular measures to stimulate the labor market and investment, such as payments for employers creating new jobs, the municipal investment program and subsidies for start-up companies, which total 0.3% of GDP). The relatively moderate increase in government expenditure growth expected by the Fiscal Advisory Council is mostly attributable to slower price growth in 2016, which determined the increase in important expenditure items in 2017 (intermediate goods, compensation of government employees (1.3% salary increase for central, regional and local government employees) and spending on pensions (0.8% increase in pensions under the statutory scheme provided for by the General Social Security Act)). In addition, the number of accommodated asylum seekers decreased in 2017, which went hand in hand with a small decrease in public spending in this area. Furthermore, thanks to the low-interest environment, interest payments on government debt declined markedly (–EUR 0.7 billion) given high amounts of refinancing volumes.

From a cyclical point of view, Austria's **fiscal stance** is **neutral** in 2017 as the economy is operating at close to full capacity (chart 1).

In sum, general government revenue and expenditure growth is expected to generate a **Maastricht deficit** of 0.7% of GDP in 2017, after 1.6% of GDP in 2016. [9] Factoring out **cyclical effects** would result in a significantly smaller contraction of the deficit in 2017. According to the fall forecast of the Fiscal Advisory Council, the **structural deficit (including eligible clauses)** amounts to 0.2% of GDP in 2017 (2016: –0.5% of GDP). Thanks to the improvement in the fiscal position, Austria is expected to **largely fulfill** the various **EU fiscal rules** in **2017**.

The **current autumn forecast of the European Commission** for Austria for 2017 yielded a higher Maastricht deficit (–1.0% of GDP) and a considerable lower improvement of the **structural deficit** (–0.5% of GDP including eligible clauses) than forecast by the Fiscal Advisory Council. This notwithstanding, the European Commission expects Austria to comply with the MTO in 2017 (taking into account the eligible clauses).

8 The changes in tax rates directly reduced payroll tax revenues in 2016.
9 The upward revisions of economic data for 2017 have caused a 0.3% of GDP decrease in the Maastricht deficit as forecast by the Fiscal Advisory Council compared with the previous forecast of spring 2017.

Despite benign economic conditions, several significant rule breaches cannot be ruled out in 2018 (unless countermeasures are taken)

2018 is expected to be marked by **high fiscal spending** due to **measures adopted in previous years** and **robust economic growth**. According to the Fiscal Advisory Council's forecast for **2018**, the anticipated upswing will **boost revenues** (+3.7% or EUR 6.6 billion), which, however, will be offset by **faster government expenditure growth** (+3.5% or EUR 6.5 billion). Next to the cuts in nonwage labor costs and the bank tax, the **economic policy measures** adopted by government toward end-2016 and in the 2017 election year will show their fiscal effects – to a large extent – only in 2018. These measures included, in particular, new subsidies for investment and the creation of new jobs (also for those in long-term unemployment), a higher than usual (additional) increase in pensions on average, the decoupling of long-term jobless benefits from partners' incomes and the abolition of legislation obligating third parties (i.e. family members) to contribute to care costs if necessary. They will raise the Maastricht deficit in 2018 by a total of EUR 2.2 billion or 0.6% of GDP. Consequently, the current Fiscal Advisory Council's forecast for 2018 predicts only a slight decrease in the **general government Maastricht deficit** to 0.6% of GDP (2017: –0.7% of GDP).

The costs arising from accommodating refugees and the banking package, one-off factors that have critically affected fiscal developments over the past few years, will de facto not have any additional budgetary effects in 2018.

From a cyclical perspective, the current estimates suggest that Austria is set to pursue an **expansive fiscal path in 2018**, unless additional countermeasures are taken, even though the domestic economy will be operating above normal capacity utilization levels.[10] The **fiscal stance** is **procyclical in 2018** (chart 1).

The structural deficit is expected to increase to **1.0% of GDP in 2018**, according to the Fiscal Advisory Council's forecast.[11] If the additional costs caused by refugee immigration and counter-terrorism measures are taken into account, that is, if the eligible clauses in assessing compliance with the EU's fiscal rules are invoked, Austria will record a **structural deficit (including eligible clauses)** of 0.7% of GDP in 2018, hence **deviating from its MTO**.

The 4.4% **increase in government expenditure** projected for **2018 clearly exceeds the 2.6% threshold**. This also constitutes a **breach of the significance threshold** as defined by the EU (table 5). The aggregate measures of expenditure and hence these breaches reflect not only the increase in expenditure but also a decline in discretionary government revenues.

Given a projected rise in the structural deficit for **2018** by 0.4 percentage points and the fact that the eligible clauses will (in part) cease to be applicable, Austria will also **fail to meet its structural adjustment requirement** – which would be to cut the structural deficit by 0.1% – while managing to keep the deviation **just below the significance threshold.**[12]

A recent **review of the current fiscal situation** included an estimate of the 2018 structural deficit carried out by the Federal Ministry of Finance. Taking into account parliamentary decisions adopted on October 12, 2017, and technical adjustments, this estimate sees a structural deficit that is 0.4% of GDP higher than that anticipated in mid-October 2017 (1.1% of GDP, Federal Ministry of Finance estimate for 2018, table

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10 Given the improved economic outlook, the Fiscal Advisory Council's estimates for the 2018 output gap on the basis of WIFO's forecast of September 2017 is +0.6% and hence higher than the European Commission's estimates (+0.1%).

11 In its current autumn forecast (November 2017), the European Commission projects the structural deficit to amount to 1.0% of GDP in 2016 and 2018 and to 0.9% of GDP in 2017.

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

5). This new estimate did not necessitate revising the estimates carried out by the Fiscal Advisory Council, however.

The **European Commission's current forecast** (November 2017) does **not** present a **brighter picture** for 2018. In fact, it predicts the 2018 Maastricht deficit to reach –0.9% of GDP, a higher level than that calculated by the Fiscal Advisory Council. As regards the structural budget balance, the European Commission and the Fiscal Advisory Council project the same values. In a comparison of budget balances for 2017 and 2018, Austria ranks in the middle among the other euro area countries (chart 3).

Debt ratio to drop sharply in 2017 and 2018

The Fiscal Advisory Council projects the **general government debt ratio** to drop to **77.8% and 74.5% of GDP** at end-2017 and end-2018, respectively, after 83.6% at end-2016. This **strong decline** by a total of 5.7 and 3.4 percentage points in 2017 and 2018, respectively, is mainly attributable to debt-reducing stock-flow adjustments of –2.7% and –0.5% of GDP and the increase in nominal GDP. The **GDP denominator effect** reduces the debt ratio by 3.8 and 3.5 percentage points in 2017 and 2018. The **stock-flow adjustments of 2017** totaled as much as EUR 9.8 billion and are made up primarily of the following factors: nationalized banks' wind-down of assets (–EUR 6.5 billion, including the wind-down of HETA debt approved by the FMA in the amount of EUR 4.5 billion), the partial release of high cash reserves (–EUR 1.8 billion), the KAF's repurchase of another tranche of debt instruments issued by HETA (–EUR 1.0 billion), payments made by Bank Austria for transferring accrued pension rights under the bank's internal pension scheme to the pension system under the statutory scheme provided by the General Social Security Act (ASVG) (–EUR 0.8 billion) and continuously high premiums from over-par issues. In **2018**, the stock-flow adjustments will be lower than in previous years, amounting to EUR 1.8 billion, and mainly attributable to the ongoing wind-down of nationalized banks' assets and premiums from over-par issues. The overall effect of the **banking package** on Austria's debt level is expected to decrease from 10.9% of GDP at end-2016 to 9.5% and 7.3% of GDP at end-2017 and end-2018, respectively.

Table 5: EU fiscal rules as applied to Austria

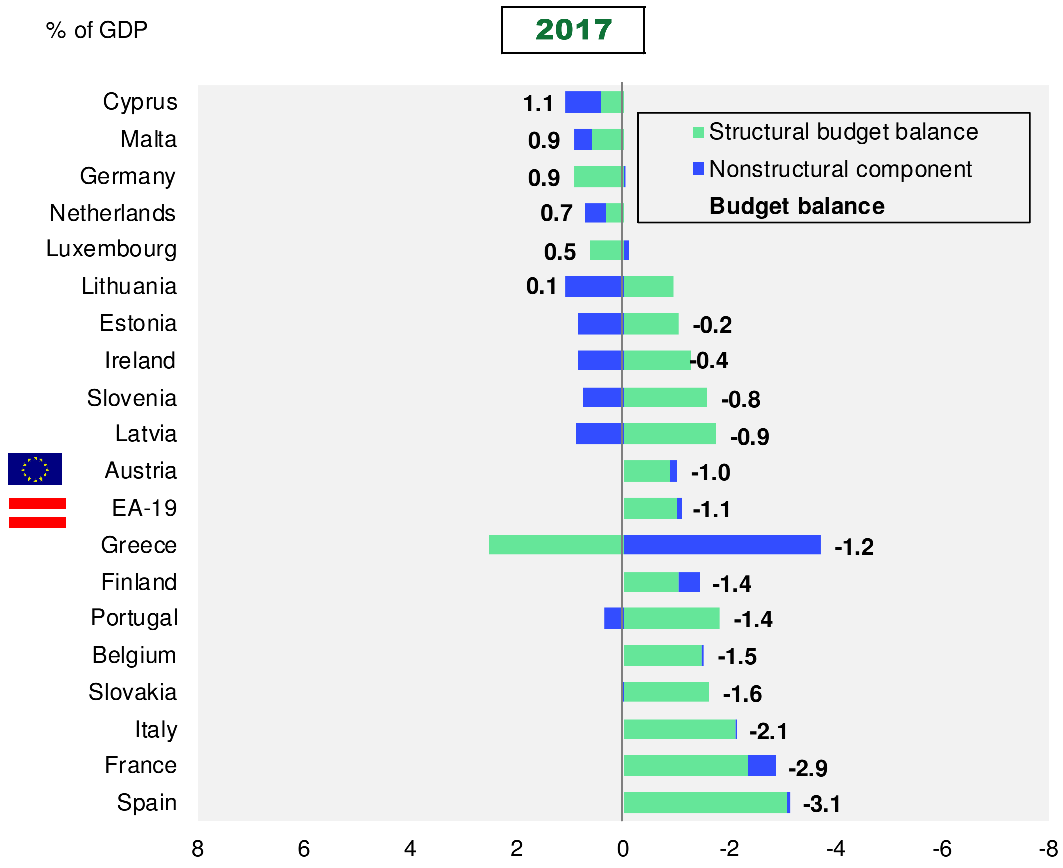
	European Commission estimate			Fiscal Advisory Council estimate			Federal Ministry of Finance estimate		
General government	**2016**	**2017**	**2018**	**2016**	**2017**	**2018**	**2016**	**2017**	**2018**
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓	✓	✓
MTO (incl. eligible clauses)[1)]	⊗	✓	⊗	⊗	✓	⊗	⊗	✓	⊗
Structural adjustment of deficit ratio	✓	✓	⊗	⊗	✓	⊗	⊗	✓	⊗
Government expenditure growth	⊗	**⊗**	**⊗**	⊗	⊗	**⊗**	⊗	⊗	**⊗**
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)									
Budget balance (Maastricht definition)	-1.6	-1.0	-0.9	-1.6	-0.7	-0.6	-1.6	-0.9	-0.8
Structural budget balance	-1.0	-0.9	-1.0	-0.9	-0.6	-1.0	-0.9	-0.7	-1.1
Structural budget balance incl. eligible clauses	-0.6	-0.5	-0.6	-0.5	-0.2	-0.7	-0.5	-0.3	-0.8
Total expenditure (nominal, adjusted, net of one-offs, change in %)	4.1	.	.	4.1	2.9	4.4	4.1	3.2	4.3
Gross debt (year-end figures)	83.6	78.6	76.2	83.6	77.8	74.5	83.6	78.3	75.2

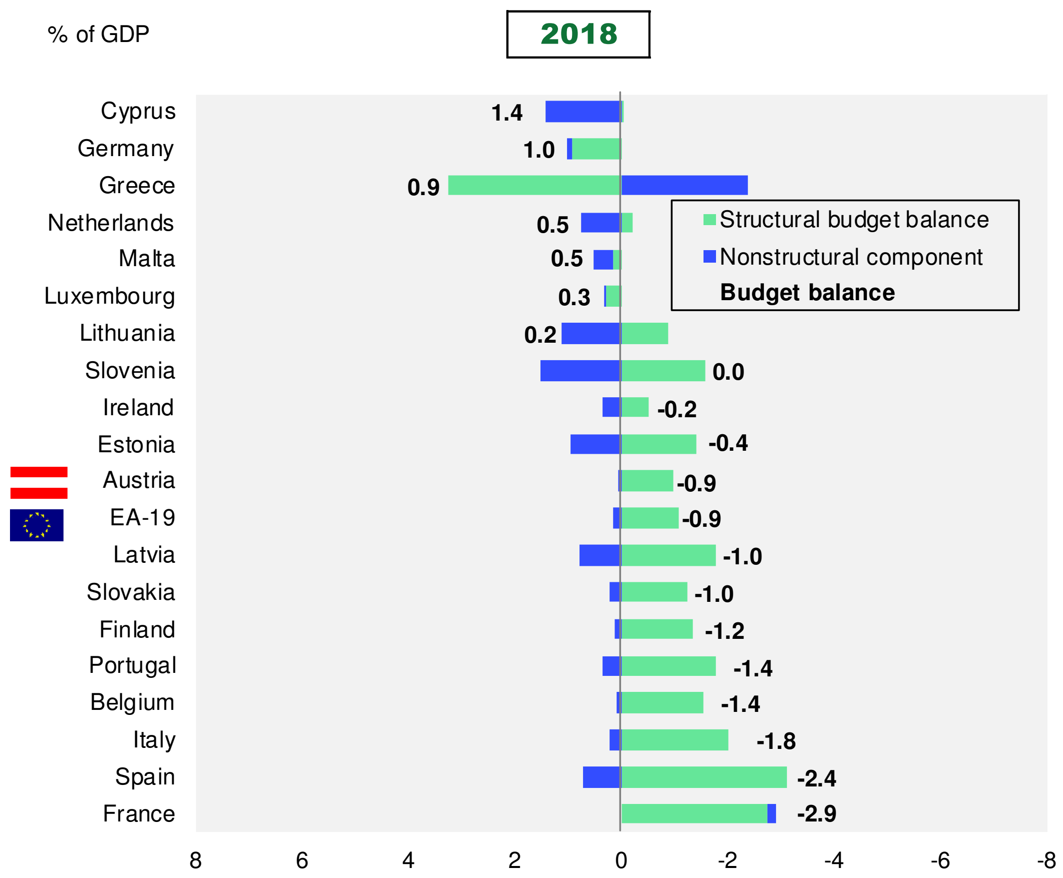
Note: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, **⊗**... fiscal rule has not been met and significant deviation
1) Tolerated deviation (0.25 percentage points) and eligible deviations, e.g. due to costs related to refugees or terrorist threat.

Source: MoF (Draft Budgetary Plan, October 2017), WIFO (Forecast, September 2017), EC autumn forecast (November 2017) and own calculations.

Chart 3

Budget balances in the euro area 2017 and 2018





Source: European Commission autumn forecast (as of November 2017).

Agreed national fiscal rules to be tested for viability as Austria's 2012 Stability Pact entered full implementation in 2017

By signing the **European fiscal compact**, Austria has committed itself to enshrine in **national law** the **medium-term budgetary objective (MTO)** of a maximum general government structural deficit of 0.5% of GDP and to implement an **automatic correction mechanism** to counteract deviations from the MTO if necessary. Austria fulfilled this obligation by adopting the **2012 Austrian Stability Pact (ÖStP)** (Federal Law Gazette I No. 30/2013), which enforces compliance with a maximum structural general government deficit of 0.45% of GDP[13] **starting from 2017**.

Regional and local governments have fulfilled the Maastricht deficit requirements as set out in the 2012 ÖStP **until 2015** but may have **deviated** from the objective in **2016**, according to the report on **2013–2016 budgetary outcomes** in light of the 2012 ÖStP issued recently by Statistics Austria.

According to the report, the **structural deficit requirements were met only to some extent in 2016**. While there were clear deviations at the federal level (incl. social security funds) and at the regional level (incl. Vienna), local governments as a whole fulfilled the structural budget requirements. However, there are still some unresolved questions regarding the interpretation of individual provisions in the 2012 ÖStP; therefore, Statistics Austria was unable to provide final results for the assessment of compliance for 2016.

The Fiscal Advisory Council has the following comments on the current interpretation of the 2012 ÖStP and the relevant calculation methods for applying the national fiscal rules:

- By referring to the Stability and Growth Pact (SGP) or an analogous description of rules, the 2012 ÖStP essentially provides for the application of the EU fiscal rules to the regional and local government levels (regional breakdown, including divested public entities). Practice has shown, however, that the **interpretation of national fiscal rules differs strongly in certain areas from the interpretation of EU rules; also, at present, the interpretation of the 2012 ÖStP** seems to be **unclear in parts and controversial among the contracting parties** (central, regional, local authorities).
- The **implementation of fiscal rules** need not be completely identical with the implementation of EU rules, but must be achieved in a way so that **compliance with the EU's general government fiscal rules is ensured**.
- The **control accounts** that have to be maintained by the central and the regional governments as well as the **interpretation and practical application of the rules should be publicly accessible** to enhance transparency and ensure the application of the correction mechanism.
- The 2012 ÖStP prescribes only an **ex-post assessment** of budgetary outcomes, which is made very **late**, i.e. in the fall of the following year. The **European Commission**, in turn, assesses Austria's overall compliance with the EU's fiscal rules under the **European Semester** in the spring. This assessment includes both an **ex-post and an ex-ante assessment** of Austria's compliance with the EU's fiscal rules on the basis of the European Commission's spring forecast.
- The 2012 ÖStP does not provide clear guidance on the **role of the Fiscal Advisory Council** and the **interfaces** between the Fiscal Advisory Council and the other **entities involved in the assessment process as set out in the 2012 ÖStP** (Statistics Austria, Court of Auditors, coordinating bodies). The Fiscal Advisory Council is charged with the timely monitoring of fiscal rules compliance and with observing **developments** that trigger, prolong or terminate the **correction mechanism** as set out in Article 7 Federal Law Gazette I No. 30/2013 and provide recommendations if applicable.[14]

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13 In the stability program, the MTO for 2017 to 2019 was set at 0.5% of GDP.

14 The open questions resulted in particular from the fact that the Fiscal Advisory Council was established only in 2013, after the adoption of the 2012 ÖStP.

Budgetary measures for 2016 and 2017

The **federal government's activities** during the 25th legislative period focused on the following targets:

- complying with EU-wide fiscal rules,
- strengthening investment in education, universities, research and development, and infrastructure to support growth and employment,
- taking measures to enhance internal and external security as well as to cope with the immigration of refugees, and
- continuing structural reforms in pensions, health care, public administration, subsidies, the labor market and taxes.

To implement this strategy, **numerous tax- and expenditure-related measures** and some **structural reforms** have been taken that have effects on the budget in the 2016 to 2018 observation period. Outlined below are the most important measures, which will in many areas also influence fiscal developments beyond this period:[15]

- **The 2015/2016 tax reform,** aimed to reduce the tax burden by more than EUR 5 billion: the **tax relief** took effect on January 1, 2016, and has been achieved mainly through **wage and income tax**. In addition, the tax burden on the corporate sector was lowered by increasing the **research premium** and the tax allowance for the issue of **employee shares**. The tax reform is to be **funded** primarily **by revenue-side measures to combat tax fraud** in the order of EUR 1.9 billion (in particular the obligation to issue receipts and use a cash register and the authorization of fiscal authorities to inspect bank accounts), through **tax increases** (e.g. partial VAT increase, increase of tax on capital gains and dividends and of capital gains tax on real estate sales; abolition of tax exemptions) and through **self-financing** effects of the tax reform (i.e. increased tax revenues through higher growth). **On the expenditure side**, around EUR 1.1 billion in spending are planned to be cut to finance the tax reform through a **"cost containment path for administration"** as well as through cuts in **subsidies**.
- **Reduction of nonwage labor costs:** The reduction of the employer contribution to the **insolvency contingency fund** by 0.1 percentage points (–EUR 0.1 billion) as from January 1, 2016, has been followed by a two-stage reduction of employer contributions to the **Family Burden Equalization Fund** from 4.5% in 2016 to 3.9% in 2018 (2017: –EUR 0.5 billion; 2018: –EUR 0.9 billion). Furthermore, the financial **burden on farmers was lowered** by partly suspending one quarterly social insurance contribution (for health and accident insurance and the public pension plan; assessment base for January 2017 = fourth quarter of 2016).[16]
- **Additional funding** has been earmarked for **universities and universities of applied sciences** from 2016 to 2020 (EUR 1.1 billion in total). In mid-**2017**, the **performance agreement** for the 2019 to 2021 period was concluded with the universities, providing for a rise in funding by EUR 1.35 billion in total. The agreement does not provide for the introduction of a **capacity-oriented** subject-related **funding of universities**. According to a decision by the Council of Ministers of November 8, 2016, EUR 700 million were to be provided for **research** until 2021. This plan was not implemented (not accounted for in the financial framework of the central government for the period from 2018 to 2021). Moreover, **EUR 1 billion** (funding extended until 2021) have been provided for upgrading the broad-

15 Not mentioned here are measures that were taken in previous years and that may have sustained effects, such as the 2011 "Loipersdorf package," the 2012 First and Second Stability Act, and the 2014 Tax Code Amendment Act.

16 One-off relief of EUR 90 million from the reserves of the farmers' health insurance fund; in turn, permanent suspension of fixed benefits under the health care and social assistance benefits act of (most recently) EUR 31 million per annum for the benefit of the regional health insurance funds (Gebietskrankenkassen).

band network in Austria; so far, little use has been made of this funding. Furthermore, work on drawing up a **housing sector program** involving both nonprofit and private investors (housing cooperatives, private residential investors) and funded through a housing bank and the European Investment Bank has been ongoing since 2016. Moreover, central government funds have been made available for 2017 and 2018 to **local governments** to invest in the modernization of infrastructure, similar to the additional investment premium for SMEs. Subsidies per investment project cover a maximum of 25% of the total costs of local infrastructure projects.

- **Economic policy packages and deregulation act:** Following a **start-up package** (totaling EUR 185 million until 2020) adopted in the summer of 2016 and providing i. a. for the suspension of nonwage labor costs for a start-up's first three employees, an **investment premium** was adopted in October 2016 which entitles **SMEs** to a reimbursement of up to 10% of their additional investment costs in 2017 and 2018, at a budgetary cost of EUR 87.5 million each year; an initiative to facilitate share ownership by employees was also adopted. The "**act on the fundamental principles of deregulation**" stipulates i. a. that as from mid-2017 for any new regulation that requires additional bureaucratic effort or has an additional financial impact a comparably complex regulation be suspended (if possible).

- **Education reform and family support measures:** This includes a strengthening of **school autonomy** and increased funds for the development of **all-day schools**. According to draft legislation, from 2018 to 2025, a total of EUR 428 million are to be allocated to infrastructural measures for afternoon childcare at primary and lower-secondary schools, EUR 248 million to covering teacher costs at primary and lower-secondary schools, and EUR 74 million above all to academic secondary schools. The **family allowance** was raised by 4% in 2016. Another rise (by 1.9%) will enter into force in January 2018.

- **Administrative reform:** Measures are to be implemented on the basis of reports by the **Committee for the Reform of Competencies and Deregulation**, which was established in 2014 (final report of June 2015), and recommendations by the **Austrian Court of Audit.** The implementation of the reform is expected to focus on smaller projects with low financial savings. Originally, the implementation was supposed to be regularly reviewed by an independent **monitoring unit** and to be documented twice a year in a progress report (in cooperation with the Court of Audit). This plan has **not yet** been **implemented**.

- **Pensions and the labor market: Structural reforms** encompass, among other measures, the **introduction** of a **part-time pension** scheme (reduced working hours for older employees with partial compensation for lost income) as of the beginning of 2016 and a **bonus-penalty system** as an incentive to employ older workers, which did not enter into force as the respective target values were reached. Labor-market policy instruments such as integration subsidies and combined wages serve to re-integrate older workers into the labor market. From 2018 onward, young adults who are unemployed will be able to benefit from a **training guarantee** up to the age of 24, and a **skilled workers scholarship** for up to three years will be available for people who have only completed compulsory education. In addition, the Council of Ministers decided in November 2016 to increase the **means-tested top-up benefits** for low-income pensioners to EUR 1,000 starting in 2017 and to pay out an **additional pension benefit** (EUR 100 per retiree) (cost: approximately EUR 180 million). Under its **2017/2018 work program** of spring 2017, the federal government launched, in particular, the **employment bonus** (reimbursement of nonwage labor costs for additional employees for three years as of July 2017, total volume: EUR 2.1 billion) and the "**20,000 employees campaign"** geared at older long-term unemployed persons until mid-2019 and involving pilot projects in 2017 (100% reimbursement of wage and nonwage labor costs for public and non-profit institutions; total volume: EUR 0.8 billion).

- **Fiscal sharing arrangement:** In 2016, a new **fiscal sharing arrangement** was adopted for the period from 2017 to 2021, which, beginning in 2017, provides **additional funds** for regional and local governments amounting to EUR 300 million a year, as well as one-time funding of EUR 125 million for expenses related to migration and integration. Beginning in 2018, setting rates for employers' and employees' contribution to the **promotion of residential buildings** will be entirely the responsibility of regional governments. At the same time, **building regulations** are to be unified throughout Austria. Early steps toward greater **task orientation** were taken as well. The amount of funding for **kindergartens**, for example, will be tied to certain criteria, starting in 2018. As of 2019, the same will apply to **primary and lower-secondary schools.** In addition, **harmonized guarantee limits**, together with a uniform calculation method, have been agreed upon for all government levels as of 2019 and a **ban on speculation** has also been agreed upon. However, the chosen objectives of disentangling joint tasks, mixed funding and transfers of funds as well as defining ways to strengthen the regional governments' autonomous tax management have not been adequately reflected in the current fiscal sharing arrangement for 2017 to 2021. Nonetheless, central, regional and local governments have agreed, inter alia, to prepare a **federal government reform** by the end of 2018, based on the work of the Austrian Convention, and to further analyze the question of **tax autonomy** in several working groups.

- **Long-term care:** As of the beginning of 2018, **regional governments** may no longer make **claims** for **compensation** from the assets of residents of long-term care institutions or their relatives (constitutional provisions in the General Social Security Act). The central government made a commitment to partly reimburse the related loss in income in the amount of EUR 100 million. A **value adjustment** is planned for the **long-term care fund** (currently EUR 350 million), beginning in 2018 (+4.5% per annum). As a **cost containment path** for long-term care, a maximum annual increase of 4.6% of costs was agreed upon for the period from 2017 to 2021. Cost reductions are to be reached i. a. through better medication management in long-term care institutions. Concrete measures have not been taken in this area yet.

- **Health care:** The newly adopted health sector arrangement between the central, regional and local authorities for the period from 2017 to 2021, in accordance with Article 15a of the Federal Constitutional Law (B-VG), is in large part similar to previous agreements. The Austrian Health Care Structure Plan (ÖSG) and the Regional Health Care Structure Plans (RSG) are the key planning tools for providing health care services on both the federal and the regional level. What is new is that compliance with the ÖSG und RSG will now be **compulsory for primary care doctors as well**. The establishment of primary care units (PVEs) will in future be guided by the RSG. PVEs are to be established in the form of practice networks, but also as central group practices or as PVEs that are integrated into hospitals. The **central and complex question of cross-sectoral financing** was not resolved. The **cost containment path** for the **health sector**, however, was extended as part of the fiscal sharing negotiations. The current rise in expenditure of 3.6% per annum is to be reduced to 3.2% per annum by 2021.

- **Parliamentary bills of October 12, 2017: Partners' income** will **cease to be taken into account** when determining the amount of **long-term jobless benefits** (as of July 2018); **contractual fees** (1% of gross rent for three years) for rental contracts will no longer be charged (–EUR 60 million); **extension** of the agreement (pursuant to Article 15a B-VG) on the **creation of more kindergarten places until 2018** (central government: EUR 52.5 million; cofinancing share for regional governments: 35% or a maximum of EUR 18.4 million); **higher increases in pension payments in 2018, especially for low-income pensioners** (+2.2% for pensions of up to EUR 1,500) and no adjustment for high-pension earners (EUR 4,980 and higher); doubling of budget funds for the **professional integration of persons with disabilities** to EUR 90 million as of 2018. **Boarding costs for vocational students** are to be covered by funds from the Protection of Wages on Insolvency Fund; the EUR 124 **fee on terminations of employment contracts** will **cease to be charged** as of 2020. According to first estimates, all these measures together will have an effect on the budget of more than EUR 500 million. Moreover, it was decided to broadly **align blue-collar workers' rights to those of white-collar workers**; however, the majority of these alignments will only be implemented as of 2021. Key issues here are the improvement of the level of protection from dismissal and uniform rules for the continued remuneration in the event of illness.

- **Debt brake**: the **2012 Austrian Stability Pact** (2012 ÖStP) introduced a multidimensional system of **national fiscal rules ("debt brake"), effective as of 2017.** These national fiscal rules, which support compliance with EU requirements, establish not only subsectoral and regional contributions to the maximum permissible structural deficit (central government and social insurance institutions: 0.35% of GDP; regional and local governments: 0.1% of GDP), but also a budget buffer ("control account") that can be used to temporarily fund a deficit overrun of up to 1.6% of GDP.[17]

Conclusions

Overall, the **observation period from 2016 to 2018** is characterized by the following developments:

- a **significant acceleration of economic growth** amid relatively high unemployment and a low level of nominal interest rates, following four years of moderate growth of below 1% of GDP;

- a **series of individual measures** by the federal government, leading to a **number of smaller structural changes** regarding e.g. elements of the education reform adopted in 2017 or the transfer to the regional governments of rate setting competences regarding the contribution to the promotion of residential buildings and of tax revenues from the contribution to the promotion of residential buildings according to the fiscal sharing agreement for 2017 to 2021;

- measures by the federal government to **revive the economy**, in particular the labor market, investment activity and private consumption;

- an **initially countercyclical fiscal path** (broadly) in line with **EU fiscal rules**. For **2018**, the Fiscal Advisory Council's current forecast predicts a **procyclical fiscal stance** unless additional countermeasures are taken. Moreover, a number of **"significant" breaches** of EU fiscal rules **cannot be ruled out** for 2018.

- a **strong decrease of the general government debt ratio** (as a percentage of GDP) **as of 2017, enhanced by one-off effects** (sale of assets of winding-down banks, payments related to the takeover of pension commitments of Bank Austria in 2017).

The Fiscal Advisory Council believes that **several key reforms have yet to be implemented.** The **Fiscal Advisory Council**, and, to some extent, also other organizations (such as the Austrian Court of Audit, the European Commission, the IMF and the Committee for the Reform of Competencies and Deregulation), have called for these reforms **for years**, but due to their complexity, differing interests and widespread impact, they have been delayed repeatedly. These key reforms are in particular:

  - **disentangling public tasks undertaken jointly by different levels of government** (stronger coherence of tasks, revenue and spending responsibilities) in tandem with measures to **reduce the administrative burden**. **Federal government reform** should be aimed at implementing broad-based transparency and begin with a critical **task review ("Who does what?")**, followed by a **reform of competencies and structures** undertaken jointly by different levels of government;

17 The 2012 Austrian Stability Pact enshrined in law the requirement to achieve a balanced structural budget (–0.45% of GDP) from 2017 onward. Austria's 2017–2019 medium-term objective (MTO) of –0.5% of GDP deviates from the 2012 ÖStP.

- Implementing **structural reforms** aimed at enhancing efficiency and sustainability in particular in the **labor market, education, subsidies, health care, pensions and long-time care**;

- designing a comprehensive **tax reform plan** that aims to **reduce the tax burden on labor**, close **tax loopholes** and **harmonize tax bases**;

- introducing greater **transparency regarding the transfer of funds** between public entities of the state (including, in particular, extra-budgetary entities).

The **low interest rate environment**, which reduces interest payments for government debt, and the gradual expiry of bank aid measures currently facilitate important reforms that **reallocate budget expenditure** toward future-oriented areas such as research and development, education or climate protection, and which may require additional funding. The budgetary flexibility caused by the low interest environment will decrease in the coming years, however.

Today's low interest rate level can be assumed not to continue **in the long run.** At the same time, **demographic developments** are expected to create **additional costs**. **Box 1** provides a summary of the results of a study by the Office of the Fiscal Advisory Council (Grossmann and Schuster, 2017) on the **long-term development of costs for long-time care in Austria.** A summary of the **international Fiscal Advisory Council workshop** on "**Fiscal Policy and Ageing**" is available at https://www.fiskalrat.at/en/workshops/fiscal-policy-and-ageing.html.

Box 1: Long-time care costs might go beyond agreed cost containment path

The fiscal sharing agreement for 2017 to 2021 defines a **cost containment path for spending on long-term care for the elderly**, capping the increase in **gross spending at the regional and local government level** at EUR 4.5 billion (2021), up from EUR 3.6 billion (2016). However, according to projections of the Office of the Fiscal Advisory Council,[18] local and regional government spending on long-term care will rise to up to EUR 5.2 billion in 2021 (depending on the underlying scenarios) in the absence of cost-cutting measures. In 2021, the long-term care cost overrun could therefore range from EUR 8 million to EUR 685 million (table 6). At the same time, an adjustment for inflation of **earmarked subsidies from the long-term care fund** and a **supplemental annual funding** for regional and local government budgets (EUR 300 million) were agreed upon.

Long-term care falls under the responsibility of the **regional governments**, but is cofinanced across all levels of government. The **central government** currently contributes just over **one-half to public funding** (of long-term care for the elderly) (2016: share of central government 51%, share of regional and local governments 49%). The Fiscal Advisory Council expects the funding share of the regional and local governments to rise to at least 52% in 2021 (federal government: 48%). In this context, transfers to the long-term care fund are set to edge up gradually, from EUR 350 million (with the federal government contributing two-thirds and the local and regional governments one-third) in 2016 and 2017 to EUR 417 million by 2021, subject to annual inflation adjustments of 4.5%. The long-term care fund in its present form will be phased out at end-2021, however. **Spending on in-home and institutional long-term care differs widely across Austria's provinces**. The available public data explain the differences only to some extent (e.g. with regard to different staff-to-resident ratios in institutional care). These gaps highlight a need for **comparative studies across Austria's provinces**, which would at the same time serve to collect information on **best practices**.

18 Grossmann, B. and P. Schuster (2017). Langzeitpflege in Österreich: Determinanten der staatlichen Kostenentwicklung. Study commissioned by the Fiscal Advisory Council. Vienna.

Table 6: Cost containment path according to 2017 fiscal sharing agreement and long-term care cost developments

EUR million	2016	2017	2018	2019	2020	2021
Long-term care costs for regional and local governments:						
Target: 2017 fiscal sharing agreement [1)]	**3,572**	**3,736**	**3,908**	**4,087**	**4,275**	**4,472**
Scenario: FISK_AWG [2)]	3,558	3,731	3,924	4,126	4,348	4,590
Scenario: FISK_S1 [3)]	3,544	3,701	3,876	4,059	4,261	4,480
Scenario: FISK_S2 [4)]	3,633	3,888	4,171	4,471	4,800	5,157
Growth: 2017 fiscal sharing agreement	**151**	**164**	**172**	**180**	**188**	**197**
Growth: FISK_AWG	137	173	192	202	222	242
Growth: FISK_S1	123	157	175	183	201	220
Growth: FISK_S2	212	255	283	300	328	357
Endowment long-term care fund:	**350**	**350**	**366**	**382**	**399**	**417**
Central government share	233	233	244	255	266	278
Regional government share	117	117	122	127	133	139

1) Growth according to cost containment path as defined in 2017 fiscal sharing agreement (+4,6% per annum as of 2017;
2) Fiscal Advisory Council (FISK) and Ageing Working Group (AWG) scenario: population forecast: EUROPOP2015; prevalence: constant in terms of age/gender; formal care: constant.
3) S1 = scenario 1. As in FISK_AWG, but relative share of healthy life years increasing.
4) S2 = scenario 2. As in FISK_AWG, but
Source: Grossmann and Schuster, 2017.

In **2015**, **general government gross spending** on long-term care for the elderly totaled EUR 5.6 billion or 1.6% of GDP. This segment of social care spending (2015: EUR 100 billion or 29.4% of GDP) comprises regional and local government spending on in-home and institutional long-term care services (EUR 3.4 billion), federal long-term care benefits (EUR 2.0 billion), benefits for long-term care leave and replacement benefits (bridging benefits) as well as subsidies for 24/7 long-term care (in sum EUR 0.2 billion). **Net general government long-term care spending for the elderly** totaled EUR 4.3 billion or 1.3% of GDP in 2015 (total gross spending minus private contributions and reimbursements from recipients of long-term care amounting to EUR 1.3 billion). As long-term care is closely linked with health care, overall costs are likely to be higher when health care costs are included.

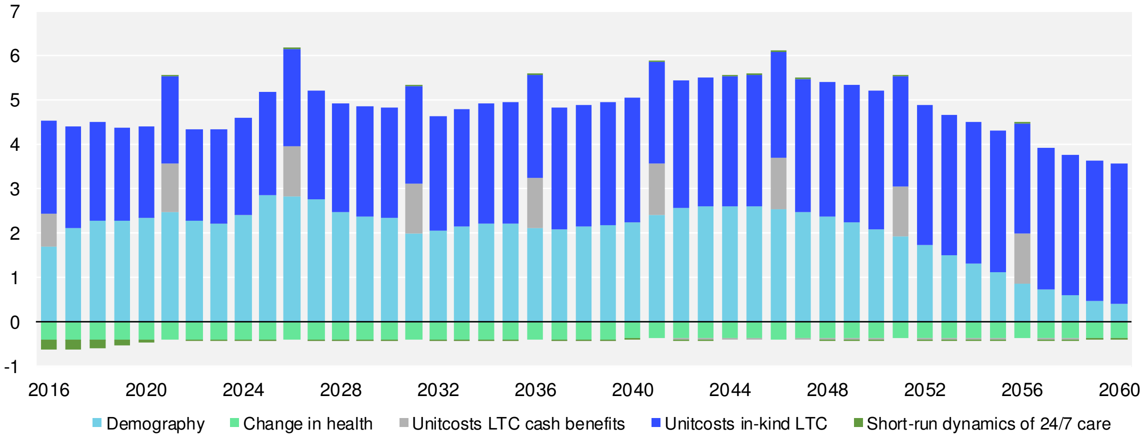
The Fiscal Advisory Council forecasts **general government spending on long-term care for the elderly** to keep rising, from 1.3% of GDP (2015) to GDP ratios ranging from 1.4% to 1.9% by **2030**, and further to a range of 1.9% to 3.6% by **2060**, depending on the underlying scenarios. Deviations in the results of individual scenarios are driven by diverging assumptions about morbidity, the propensity to seek formal public long-term care as well as the indexation of unit costs.

The average annual **growth rates of long-term care costs** are projected to lie between 4.4% and 6.2% in the period from 2015 to 2030, depending on the underlying scenarios. While spending on **long-term care benefits**, dampened by below-average inflation adjustments, is projected to grow at average rates of 2.5% to 5.2% per year, **net spending on (formal) long-term care services** will increase more rapidly (between 5.8% and 7.8% per year). Spending on subsidized **24/7 long-term care** – which was considered to be a substitute for institutional long-term care in the projection – is expected to rise at above-average rates ranging from 4.2% to 7.0% per year. Chart 4 shows the annual growth contributions of long-term care costs for major components (i. a. **demography and unit costs for long-term care services**).

Chart 4: Break-down of annual growth of public costs of long-term care

Break-down of yearly public LTC cost growth (FISK_S1)

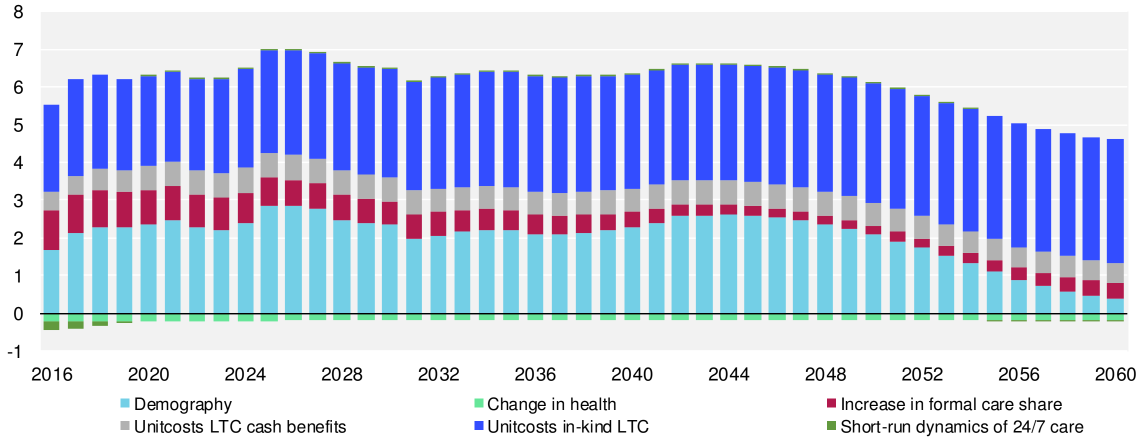
in percentage points



Source: own calculations.

Break-down of yearly public LTC cost growth (FISK_S2)

in percentage points



Source: own calculations.