AUSTRIA'S FISCAL POSITION AND COMPLIANCE WITH EU FISCAL RULES

(EXTRACT FROM THE FISCAL RULES COMPLIANCE REPORT 2018–2023 BY THE FISCAL ADVISORY COUNCIL, MAY 2019)

In the following section, we **compare** the **general government fiscal path defined in the current stability programme for 2019 and 2020 with the Fiscal Advisory Council's spring forecast**. Our budget forecast also includes our own output gap calculations. Furthermore, we **evaluate** Austria's **compliance with EU fiscal rules**. In its spring forecast, the Fiscal Advisory Council calculates the output gap according to the European Commission's methodology. The output gap is used to cyclically adjust the budget balance. The results correspond to those released by the Austrian Institute of Economic Research (WIFO).

A summary of results, including the Fiscal Advisory Council's conclusions and recommendations, is provided in the **Executive Summary** of this report.

The Fiscal Advisory Council's current spring forecast considers all measures whose effects on public finances over time were adequately assessable (as of end-May 2019). The measures include federal government **measures** adopted **before December 2018**, above all the 2017/18 work program, parliamentary bills adopted on October 12, 2017, and growth-enhancing measures (e.g. to expand broadband Internet). Consideration is also given to measures based on the federal government's 2018/2019 twin budget. These include cutting various state subsidy programs (e.g. "employment bonus" program, 50+ employment initiative, start-up package), postponing investments by the Austrian Federal Railways and introducing a higher tax relief for families with children ("Familienbonus Plus") as well as **newer measures** that were adopted after **December 2018**. These more recent measures primarily include the first stage of the **2020 tax reform** and the **acquisition of military helicopters**.

The **projected fiscal path** and **enactment of government-adopted measures** are subject to a **particularly high degree of uncertainty** given the **premature end of the 26th legislative session** and the upcoming reelection of parliament in September 2019. In assessing Austria's fiscal rule compliance, we provide both baseline scenarios that include discretionary measures and "no policy change" scenarios, in which we only consider measures for which the legislative process was already completed at end-May (see box 1 and the section on sensitivity scenarios below).

In this section, we will not discuss the results of the **2012 Austrian Stability Pact**, which is an agreement between the federal, regional and local governments in accordance with Article 15a Federal Constitutional Law. We assess compliance with **national fiscal rules** (for the federal government sector as well as for regional governments and local governments in each province) in **section 7** of the German version of this report.

Austria posts solid budget surpluses for 2019 and 2020, and clearly complies with Maastricht deficit cap of 3% of GDP

Following a small surplus of 0.1% of GDP in 2018, the **general government budget balance (Maastricht definition)** is set to improve further in **2019 and 2020** according to the **Fiscal Advisory Council's spring forecast** – despite the introduction of "Familienbonus Plus" and the first stage of the 2020 tax reform. The **budget surpluses** of 0.4% of GDP expected for both 2019 and 2020 are largely attributable to the following factors:

- the cooling yet still robust economy,

- the scaling down of procyclical measures (e.g. "employment bonus" program and investment premiums), and
- moderate spending growth of +2.4% for 2019 and +2.9% for 2020, which is being favored by the low interest rate environment and is below the five-year average of nominal GDP (2015–2020: +3.8%).

The **general government budget surpluses** as a percentage of GDP (Maastricht definition) forecast by the **Fiscal Advisory Council** will remain **clearly within the limits of the Maastricht deficit reference value** of 3% of GDP in 2019 and 2020. This also applies to the forecast made by the federal government in its current stability programme, which puts the budget balance at 0.3% of GDP (2019) and 0.2% of GDP (2020), respectively. This means that Austria will **clearly comply** with the (nominal) **deficit rule** over the entire forecast horizon, and **no excessive deficit procedure is likely to be launched** (table 1).

Table 1: Compliance with EU fiscal rules according to the Fiscal Advisory Council's 2019 spring forecast and the government's 2019 stability programme

General government	EC	Fiscal Advisory Council estimate			Federal Ministry of Finance estimate		
	2018	2018	2019	2020	2018	2019	2020
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓
MTO (incl. eligible clauses)[1]	✓	✓	✓	✓	✓	✓	✓
Government expenditure growth	⊗	⊗	⊗	✓	⊗	⊗	✓
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)							
Budget balance (Maastricht definition)	0.1	0.1	0.4	0.4	0.1	0.3	0.2
Structural budget balance	-0.5	-0.4	0.1	0.1	-0.4	-0.1	-0.1
Structural budget balance incl. eligible clauses	-0.1	-0.1	0.1	0.1	-0.1	0.0	-0.1
Total expenditure (nominal, adjusted, net of one-offs, change in %)	.	3.9	3.3	3.5	3.7	3.7	3.4
Gross debt (year-end figures)	73.8	73.8	69.6	66.4	73.8	69.6	66.5

Note: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, ⊗... fiscal rule has not been met and significant deviation[2]

1) Tolerated deviation (0.25 percentage points) and eligible deviations, e.g. due to costs related to refugees or terrorist threat.

2) A deviation is deemed significant if the structural deficit deviates at least by 0.5% of GDP from the structural adjustment path or the MTO within one year or cumulated over two years.

Source: FISK (Forecast, May 2019), MoF (Stability Programme, April 2019), WIFO (Forecast, March 2019), EC (Forecast, May 2019), own calculations.

Medium-term budgetary objective will be clearly reached in 2019 and 2020

According to the **Fiscal Advisory Council's forecast,** the structural balance will turn positive in 2019. Following –0.4% of GDP in 2018, Austria is projected to record a slight **structural surplus of 0.1% of GDP** in both 2019 and 2020. Austria will **clearly achieve its medium-term budgetary objective (MTO)** (maximum deficit of 0.5% of GDP) over the entire forecast horizon. When assessing compliance with fiscal rules, it is possible to take into account costs arising from unusual events. In Austria, such **additional costs** related to refugee migration (2015, 2016 and 2017) and to anti-terrorism measures (2016, 2017). They will only play a negligible role in the current forecasting period: The temporary, tolerated deviation from the structural budget path amounting to 0.03% of GDP in 2019 will end thereafter.

Since Austria will fulfill its MTO over the forecast horizon, **deviations from the expenditure rule**, even if "significant," will **not trigger** an **early warning** by the **European Commission**. Decisions on whether to activate the early warning mechanism (significant deviation procedure) are taken by the Council of the European Union every spring, based on the **European Commission's overall assessment** using **realized data**.

Box 1: Compliance with EU fiscal rules excluding 2020 measures that are still being implemented

Given the **premature end of the 26th legislative session** and parliamentary reelections scheduled for fall 2019, it remains to be seen whether the measures that were still being implemented or subject to an on-going legislative process at the cutoff date of this report will actually be realized. This uncertainty relates to measures that would primarily translate into reduced revenue and increased expenditure – above all cuts in health insurance contributions for low income earners as well as the acquisition of military helicopters. Some measures (e. g. digital tax bill) would raise taxes. Altogether, the measures total a net budget volume of –EUR 0.9 billion (or –0.2% of GDP) for the year 2020.

Table 2: Compliance with fiscal rules excluding 2020 discretionary measures

	EC	Fiscal Advisory Council estimate		
General government	**2018**	**2018**	**2019**	**2020**
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓
MTO (incl. eligible clauses)[1)]	✓	✓	✓	✓
Government expenditure growth	⊗	⊗	⊗	✓
Reduction of debt ratio	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)				
Budget balance (Maastricht definition)	0.1	0.1	0.4	0.6
Structural budget balance	-0.5	-0.4	0.1	0.3
Structural budget balance incl. eligible clauses	-0.1	-0.1	0.1	0.3
Total expenditure (nominal, adjusted, net of one-offs, change in %)	.	3.9	3.3	3.1
Gross debt (year-end figures)	73.8	73.8	69.6	66.2

Note: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, ⊗... fiscal rule has not been met and significant deviation[2)]
1) Tolerated deviation (0.25 percentage points) and eligible deviations, e.g. due to costs related to refugees or terrorist threat.
2) A deviation is deemed significant if the structural deficit deviates at least by 0.5% of GDP from the structural adjustment path or the MTO within one year or cumulated over two years.
Source: FISK (Forecast, May 2019), MoF (Stability Programme, April 2019), WIFO (Forecast, March 2019), EC (Forecast, May 2019) and own calculations.

If these uncertain measures are excluded from the Fiscal Advisory Council's current spring forecast, this implies the following for Austria's compliance with **EU fiscal rules** in 2020:

- improvement of the Maastricht balance and the structural budget balance by 0.2 percentage points each
- faster reduction of the government debt ratio (by 0.2 percentage points)
- smaller increase in the adjusted expenditure aggregate (by 0.4 percentage points) because of direct expenditure savings but also because of lower discretionary revenue losses

Under this scenario, Austria would comply with **EU fiscal rules** in 2020 by an even **more comfortable margin than previously anticipated.** However, in view of Austria's current domestic political situation, there is generally **high uncertainty** regarding the **future budget path**.

As the Fiscal Advisory Council's spring forecast predicts that Austria will reach its MTO in the years 2019 and 2020, requirements for the **adjustment of the structural budget balance** will become less relevant.[1]

Austria's current **stability programme** likewise suggests that the **MTO will be met** during the entire programme period. Different estimates of the budget balance (Maastricht definition) fully explain slight differences in the Fiscal Advisory Council's spring forecast and the government's stability programme when it comes to structural budget balance projections for the years 2019 and 2020 (+0.1% versus –0.1% of GDP for 2019 and 2020 each). The underlying values for the output gap and one-off measures are identical in both forecasts.

Government expenditure to exceed benchmark in 2019, but deviation is not "significant"

Annual growth of **nominal government expenditure (adjusted)**,[2] which is the applicable value for measuring compliance with the expenditure rule, will average 3.6% annually for the period from 2018 to 2020 according to the Fiscal Advisory Council's forecast. Annual growth rates come to 3.9% (2018), 3.3% (2019) and 3.5% (2020). This not only reflects **expenditure increases** but, especially in 2019 and 2020, also a **decline in discretionary government revenues** caused by the introduction of "Familienbonus Plus" as well as the 2020 tax reform, which will increase the expenditure aggregate accordingly.

Three components play a role in determining the **expenditure benchmark**: the average growth of potential output, the deviations from the MTO expected by the European Commission and the scope of eligible clauses.[3] Tolerable deviations from the budget path under eligible clauses, which had been granted for refugee migration and anti-terrorism measures from 2015 to 2017, will for the last time apply in 2019 (totaling 0.03% of GDP). Requirements under the expenditure rule (add-ons to, or deductions from, the reference rate for annual growth of public expenditure) will thus be more stringent for 2019 and less stringent for 2020. According to the **current Fiscal Advisory Council's forecast, Austria will fail to comply with these requirements only in 2019.**

Considering the applicable add-ons to, or deductions from, the reference rate for net nominal annual public expenditure growth, Austria will have to comply with the following **expenditure benchmarks**:[4]

- +3.3% in 2018 (taking into account an add-on of 0.5 percentage points as the deviation from the 2017 MTO is smaller than the scope of eligible clauses),
- +2.9% in 2019 (taking into account a deduction of 0.6 percentage points resulting from the deviation from the 2018 MTO[5]; eligible clauses will apply only marginally in 2019).
- +4.4% in 2020 (taking into account a marked 0.9 percentage point add-on based on the European

1 In line with the requirement defined by the European Commission, Austria's structural budget balance would need to improve by 0.3 percentage points in 2019. This requirement is calculated based on the deficit ratio for 2018 (–0.8% of GDP), which was frozen at the "most favourable value" for 2018 according to the European Commission's 2018 spring/fall forecast, minus the MTO (–0.5% of GDP) plus eligible "unusual events" clauses (0.03% of GDP). From today's perspective, it seems likely that this requirement will be substantially loosened for the year 2019; this will be determined with final effect in spring 2020. For 2020, there is no structural adjustment requirement as the European Commission anticipates that the MTO will be met in 2019.

2 Aggregate expenditure does not include interest payments, cyclical spending on unemployment benefits and one-off measures. Additional discretionary revenues are subtracted; discretionary shortfalls in revenues are added.

3 As long as a Member State fails to comply with its MTO, its spending is constrained by country-specific expenditure benchmarks ensuring that the structural budget balance is adjusted toward the MTO as required.

4 For details on how the expenditure benchmarks are set, see section 4.4 of the German version of this report.

5 This deviation was caused by the "freezing" principle and will be finally evaluated in spring 2020 in an ex post assessment by the European Commission. From today's perspective, we expect that the requirement for 2019 will be loosened.

Commission's assumption that the MTO will be clearly achieved in 2019).

A comparison of the **growth rates of aggregate nominal expenditure (adjusted)** based on the **Fiscal Advisory Council's** current **spring forecast** with the **expenditure benchmarks** yields the following results:[6]

- In **2018,** the above-average increase in aggregate nominal expenditure (**3.9%**) was above the **benchmark.**
- Based on our forecast, we expect **aggregate expenditure** to **grow** at a rate above the reference value of 2.9%, i.e. by **3.3% in nominal terms in 2019**. This will primarily be due to inflation-dependent areas of spending and a decline in discretionary government revenues (mostly caused by "Familienbonus Plus"), which in net terms also lead to an increase in aggregate spending. In this case, Austria will **fail to comply with the expenditure rule**. Since Austria also failed to comply with the expenditure rule in 2018, spending growth projected for 2019 will allow Austria to remain only **slightly below** the value that would constitute a **significant deviation** (as defined by the EU) in a **two-year assessment**.
- **In 2020**, growth in nominal (adjusted) government expenditure will amount to 3.5% – despite discretionary spending increases and revenue declines against the previous year – and will remain **clearly below the benchmark** of 4.4%.

According to the Fiscal Advisory Council's current forecast, the **early warning mechanism (significant deviation procedure) will** most likely **not be triggered**. From today's perspective, expenditure will not significantly exceed the benchmark and the MTO should be reached throughout the forecast horizon. Moreover, we assume that the expenditure benchmark will be raised after the European Commission's ex post assessment of the year 2019 in spring 2020. This should result in a smaller deviation from the spending rule, ceteris paribus. The results of the **current stability programme** suggest similar conclusions, even if the 2019 deviation from the expenditure rule is slightly above the value defined as significant by the EU on this basis. The budget data according to the stability programme confirm the **Fiscal Advisory Council's assessment** stating that in 2019 and 2020, **compliance with the EU expenditure rule will be Austria's main challenge again.**

Austria set to clearly comply with debt rule in 2019 and 2020

According to the **Fiscal Advisory Council's spring forecast**, Austria will meet all **three debt rule benchmarks** (i.e. the backward-looking, forward-looking and cyclically adjusted benchmark) **from 2018 to 2020.** Apart from the solid fiscal target, this development is primarily attributable to the winding down of assets held by state-owned banks and persistently robust economic growth. The general government **debt path complies** with the **requirements under the EU debt rule**, according to both the **Fiscal Advisory Council's assessment** and the **current stability programme**.

Sensitivity scenarios

In this section, we will compare different **scenarios in terms of compliance with EU rules** based on the budget paths presented in the Fiscal Advisory Council's spring forecast and the federal government's stability programme (Federal Ministry of Finance, 2019). The scenarios reflect **different combinations of discretionary measures** that relate in particular to the 2019/2020 tax reform. In our sensitivity analysis, we take into account the premature termination of the current legislative session and the parliamentary reelections scheduled for September 2019. In light of these recent events, it has become highly uncertain whether discretionary measures that had already been decided upon will be implemented.

6 The notable decline in interest payments does not have an expenditure-decreasing effect, as this expenditure category is not considered in the calculation of aggregate expenditure.

Table 3: Austria's fiscal position and compliance with EU fiscal rules in different scenarios for 2020

General government	Fiscal Advisory Council estimate[1] incl. discretionary measures 2019	2020	Fiscal Advisory Council estimate[1] excl. discretionary measures 2019	2020	Federal Ministry of Finance estimate[2] incl. discretionary measures 2019	2020	Federal Ministry of Finance estimate[2] excl. discretionary measures 2019	2020
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓	✓
MTO (incl. eligible clauses)[3]	✓	✓	✓	✓	✓	✓	✓	✓
Government expenditure growth	⊗	✓	⊗	✓	⊗	✓	⊗	✓
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)								
Budget balance (Maastricht definition)	0.4	0.4	0.4	0.6	0.3	0.2	0.3	0.4
Structural budget balance	0.1	0.1	0.1	0.3	-0.1	-0.1	-0.1	0.0
Structural budget balance incl. eligible clauses	0.1	0.1	0.1	0.3	0.0	-0.1	0.0	0.0
Total expenditure (nominal, adjusted, net of one-offs, change in %)	3.3	3.5	3.3	3.1	3.7	3.4	3.7	3.0
Gross debt (year-end figures)	69.6	66.4	69.6	66.2	69.6	66.5	69.6	66.3

Note: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, ⊗... fiscal rule has not been met and significant deviation[4]

1) Measures in question (to be implemented or are stuck to the law process) covering shortfalls due to the tax reform, tax increases (e.g. digital tax) and additional expenditure (military helicopters) in net total -0,9 bn EUR or -0,2% of GDP in 2020.

2) Based on a "no-policy-change"-scenario according to the stability programme: discretionary measures in net total of -0,9 bn EUR or -0,2% of GDP in 2020.

3) Tolerated deviation (0.25 percentage points) and eligible deviations, e.g. due to costs related to refugees or terrorist threat.

4) A deviation is deemed significant if the structural deficit deviates at least by 0.5% of GDP from the structural adjustment path or the MTO within one year or cumulated over two years.

Source: FISK (Forecast, May 2019), MoF (Stability Programme, April 2019), WIFO (Forecast, March 2019) and own calculations.

In the **outlined scenarios**, we take into account the 2019/2020 tax reform and other discretionary measures **planned for the year 2020** as follows:

- **Fiscal Advisory Council forecast including or excluding discretionary measures**: Public revenue and expenditure according to the Fiscal Advisory Council's current spring forecast, including or excluding revenue losses (above all: reduced health insurance contributions for low income earners), expenditure increases (acquisition of military helicopters), tax-increasing measures (e.g. digital tax bill). Such measures, which total –EUR 0.9 billion or –0.2% of GDP in net terms, had been decided upon by end-May 2019 but have not yet been implemented or legally enacted.

- **Federal Ministry of Finance stability programme including or excluding discretionary measures**: Public revenue and expenditure according to the current stability programme of April 2019, including or excluding discretionary measures (above all: tax reform; to a lesser extent: expenditure increases) with a net volume of –EUR 0.9 billion or –0.2% of GDP. The analytical remarks on the scenario that disregards discretionary measures are based on the budget path set forth in the current stability programme that was defined under a no-policy change assumption (Federal Ministry of Finance, 2019).

If Austria wants to reach its **medium-term budgetary objective** and implement the reported discretionary measures – which would put a **strain on public finances** in net terms – it would need to generate surpluses (Maastricht definition) in the event of a discretionary volume of 0.2% of GDP or more: Once we add the cyclical component for the year 2020 (+0.3% of GDP) to the MTO, which allows a permissible structural budget deficit of 0.5% of GDP at most, we arrive at a deficit of 0.2% of GDP (Maastricht definition). This figure corresponds to the MTO set for 2020. In other words, any discretionary measures that cause a **fiscal burden of more than 0.2% of GDP** need to be matched with **Maastricht surpluses**. The two forecast scenarios that exclude discretionary measures result in surpluses of 0.6% and 0.4% of GDP, respectively, for 2020. Both values would clearly suffice to cover the envisaged discretionary volume of 0.2% of GDP.

In conclusion, we note that from today's perspective, Austria can be expected to **fully comply with EU fiscal rules** in **2020 in all outlined scenarios**. The scenarios include or exclude discretionary measures while being based on the Fiscal Advisory Council's spring forecast and the budget path specified in the current stability programme of April 2019.

European Commission expects Austria to broadly fulfill structural budget requirements in 2019 and 2020

Based on its **spring 2019 forecast**, the **European Commission** expects Austria's structural budget balance to steadily improve in 2019 and 2020 (2018: –0.5% of GDP; 2019: –0.1% of GDP; 2020: 0.0% of GDP). For 2020, the European Commission identifies a structural deficit that lies between the figures expected by the Federal Ministry of Finance (–0.1% of GDP) and the Fiscal Advisory Council (+0.1% of GDP). In analogy with the current stability programme and the Fiscal Advisory Council's 2019 spring forecast, the European Commission's spring forecast also anticipates that **Austria will clearly reach its MTO** in the years **2019 and 2020**. Like the other forecasts, the European Commission expects a **deviation** from the **expenditure rule** in **2019**. The European Commission anticipates the deviation to be **"significant"** according to the EU definition (two-year assessment).

In spring 2019, the European Commission found that Austria had only made **limited progress** in implementing its country-specific recommendations of May 2018[7] and once more requested that Austria implement **structural measures** to strengthen the sustainability of its health care, long-term care and pension systems and to streamline and simplify the structures governing federal responsibilities and financing in Austria (European Commission, 2019a).[8]

7 See https://ec.europa.eu/info/sites/info/files/file_import/2018-european-semester-country-specific-recommendation-commission-recommendation-austria-en.pdf.

8 See https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-austria_en.pdf.